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leader

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Politics this week

Oct 19th 2006
From The Economist print edition

Reuters

The United Nations Security Council imposed sanctions on **North Korea** to protest against its nuclear bomb test. Condoleezza Rice, America's secretary of state, headed to Tokyo, Seoul and Beijing to ask that the sanctions be fully implemented (including a provision to search North Korean ships). China, North Korea's nearest thing to an ally, suggested it would not do so. North Korea said it viewed the sanctions as an act of war and reports suggested it was preparing a second nuclear test. See article

Tamil rebels carried out attacks on government targets in **Sri Lanka**, including a suicide-bomb aimed at a naval convoy that killed over 100 people, most of whom were sailors. The government continued an air attack on a rebels stronghold, banishing hope that the war will end soon. See article

Hafeez Saeed, the founder of Lashkar-e-Toiba, the biggest jihadist group fighting Indian rule in **Kashmir**, was released from custody in Pakistan. Mr Saeed heads another Islamist group, Jamaat-ud-Dawa, that is banned by America, but not by Pakistan. He denies America's claim that the group raises funds for fighters.

Day by day

With American casualties rising in **Iraq**—more than 60 American soldiers have been killed so far this month—the debate over possible new strategies in the conflict intensified in Washington. See article

The police in **Israel** recommended that the country's figurehead president, Moshe Katsav, should face charges of rape. But unless he steps down, he cannot be tried until his term ends next August. See article

A state of emergency was declared in the **Nigerian** state of Ekiti after the governor was impeached on corruption charges. Nigeria's financial crimes commission is investigating 33 of the country's 36 governors for corruption. See article

After elections in **Côte d'Ivoire** were delayed because of the slow pace of disarmament by government and rebel militias, African leaders recommended that President Laurent Gbagbo be allowed to stay in office until a ballot can be held, but with reduced powers.

South Africa secured a non-permanent seat at the UN Security Council for the first time. The government said it would use its position to campaign for UN reform, including the expansion of the council to include a permanent African member.

Meanwhile

Hugo Chávez's expensive campaign to win **Venezuela** a seat on the Security Council appeared to be heading for defeat. Venezuela trailed its American-backed rival, **Guatemala**, in more than 20 rounds of voting, but neither won the required two-thirds majority. Diplomats expected that a third Latin American country would emerge as a compromise candidate. See article

AP

The remains of **Juan Domingo Perón**, Argentina's most revered and most divisive political leader, were reburied in a new mausoleum outside Buenos Aires. The ceremony, attended by thousands, was marred when fighting broke

out between rival factions of the ruling political movement that bears his name.

Álvaro Noboa, a banana magnate and **Ecuador's** richest man, came first in the country's presidential election, winning 26.2% of the vote. He will face a run-off ballot against Rafael Correa, a leftist, next month. See article

Andrés Manuel López Obrador, the centre-left loser of **Mexico's** presidential election, suffered a second defeat when his party's candidate lost a gubernatorial election in his home state, Tabasco. The defeat will undermine Mr López Obrador's campaign of “civic resistance” against Mexico's government.

The statute on liberty

Amid complaints from civil-liberties groups that he was reversing basic constitutional rights, George Bush signed into law new rules on the **detention and prosecution of terrorism suspects**. Republicans seized on the act to bash Democrats for being soft on security issues. Lawyers predicted challenges to the legislation, which was partly designed to clarify the law.

An **earthquake** of magnitude 6.7 shook Hawaii, causing some structural damage but no serious injuries. Possibly still stung by criticisms over Hurricane Katrina (and maybe with one eye on the mid-term elections) the White House declared it a disaster and ordered the release of federal assistance. It did the same for a snowstorm in upstate New York and flooding that occurred—in August—in Alaska.

Another potential congressional **scandal** brewed as Curt Weldon, a Republican who is in a tight election race in his suburban Philadelphia district, confirmed that the Justice Department was investigating his connection to lobbying contracts through his daughter's firm. Mr Weldon blamed “left-wing liberal activists” for the timing of the investigation.

Arnold Schwarzenegger burnished his green credentials by announcing a pact with north-eastern states, including New York, to co-ordinate existing plans on reducing **greenhouse-gas emissions**. See article

Doesn't inspire

The **Polish government** survived a vote of confidence after the conservative Law and Justice party lured the populist Self Defence party, led by Andrzej Lepper, back into a coalition. Mr Lepper, who was sacked a month ago, will be the agriculture minister. The opposition accused the government of “squandering Poland's prestige”.

Turkey continued to protest over the French National Assembly's vote for a bill to criminalise denial of the 1915 Armenian genocide. Many Turks detected yet another attempt to derail their efforts to join the European Union. See article

The new centre-right government of **Sweden**, led by Fredrik Reinfeldt, had a rocky start when two female ministers were forced to quit. One had registered her nanny improperly; the other had not paid her television licence.

Iceland upset conservationists by announcing a resumption of commercial whaling. It plans to take nine fin whales, an endangered species, and 30 minke whales a year.

France's three candidates for the Socialist Party nomination for president in next year's election staged a televised debate. The front-runner, Ségolène Royal, emerged without too much damage, although some recent polls have put her behind the main centre-right candidate, Nicolas Sarkozy.

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Business this week

Oct 19th 2006
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As the scandal over backdated **stock options** continued to gather pace, William McGuire resigned as chairman and chief executive of **UnitedHealth**. An investigation carried out for the health insurer by a law firm reported irregularities in granting stock options (worth some $1 billion) to Mr McGuire stemming from contract negotiations in 1999. The report also raised concerns about the depth of a financial relationship between Mr McGuire and the then acting-chairman of the board's compensation committee. See article

A judge dismissed the convictions for fraud handed down to **Kenneth Lay** in May. As Enron's former boss died from heart failure in July, before he was sentenced or could launch an appeal, the judge followed precedent by “vacating” the convictions, which also stops the government from seeking compensation from Lay's estate.

No longer the Second City

In a deal that ends more than a century of rivalry, **Chicago Mercantile Exchange** agreed to buy the **Chicago Board of Trade** for $8 billion, the biggest merger yet in a spate of tie-ups among financial exchanges. Both institutions specialise in derivatives. CME's former chairman said the deal sealed the transformation of Chicago from the world's “hog butcher” to its “risk manager”. See article

Banca Popolare di Verona e Novara agreed to buy **Banca Popolare Italiana** for *euro*8.2 billion ($10.3 billion), creating Italy's fourth-biggest bank. BPI was at the centre of last year's scandal that brought down Antonio Fazio as governor of the Bank of Italy. The deal is seen as further evidence that the effort to encourage consolidation among the country's banks is working.

Citigroup broadened its presence in Turkey's expanding financial-services industry by agreeing to buy a 20% stake in **Akbank** for $3.1 billion. It was Citigroup's first big deal since the Federal Reserve lifted its ban on the company from making acquisitions after it became embroiled in a series of regulatory problems.

After it apparently attracted record interest from institutional investors, **Industrial and Commercial Bank of China's** dual-listed public offering was opened to individual investors. Hundreds of people queued to get a copy of the prospectus ahead of this month's flotation.

A sale on high waters

The management of RWE, a German utility group, agreed to sell **Thames Water**, Britain's biggest water company which it bought in 2000, to a consortium led by **Macquarie Bank** for £8 billion ($15 billion) including debt. It is the third announced takeover of a British water company this month. The investment group trying to buy **Anglian Water's** parent company raised its stake in the company to fend off potential counterbids. See article

After much speculation about a deal, **Tata Steel**, based in India, confirmed it was proposing to buy **Corus**, an Anglo-Dutch steelmaker. Tata values Corus at $10 billion, including debt, though other groups are thought to be interested in launching rival bids.

A week after Google agreed to buy YouTube, **Universal Music** launched lawsuits against two smaller video-sharing websites, **Bolt** and **Grouper**, for copyright infringement.

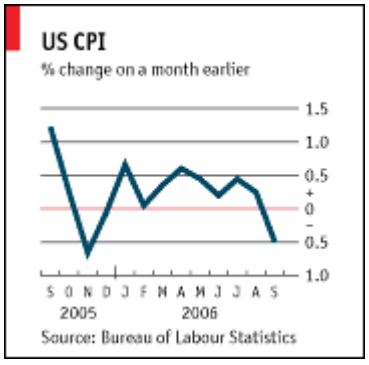
The rivalry between **Intel** and **Advanced Micro Devices** was highlighted as both chipmakers reported

quarterly earnings. Particular scrutiny was given to shipments of microprocessors, on which both companies compete intensely. Intel enjoyed record shipments of microprocessors, and although its net profit dropped by 35% compared with a year ago, its share price was buoyant. AMD's shipments also rose, but its gross profit margin was squeezed by sagging prices and its share price fell, even though net profit rose by 77%.

In one of the biggest-ever **residential-property** transactions, MetLife, an insurer, agreed to sell two apartment complexes it owns in **New York** for $5.4 billion to two buyers, one of which is Tishman Speyer, a company that owns several prestigious buildings worldwide, including the Chrysler Building and the Millbank tower in London. The deal is controversial, however, as most of the flats in the buildings are rent-controlled; MetLife developed the properties after the second world war to house returning troops. See article

Pick a number

America's headline **inflation** rate fell by 0.5% in September on the back of declining energy prices, the biggest monthly drop since last November. The news was one factor that helped the **Dow Jones Industrial Average** to push past 12,000, briefly, for the first time. But the Federal Reserve will not be so optimistic: core inflation, which excludes energy and food, reached 2.9%, its highest annual rate since February 1996. See article



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The world economy

America drops, Asia shops

Oct 19th 2006
From The Economist print edition

Thanks to the vigour of Asia's consumers, it is a good time for the American economy to slow

IT IS a commonplace that American consumers have kept the world economy spinning. Asians are frugal, Europeans are gloomy, so if Americans do not keep spending as fast as they have been lately, the world economy is in trouble.

That view will be tested over the next couple of years as Americans adjust to the end of their housing bonanza. By virtually every measure America 's housing market is in trouble. Home sales and residential construction are tumbling, the overhang of unsold homes has soared and, according to some statistics, house prices have started to slide. And despite the odd bit of good news, such as this week's figures showing that housing starts rose unexpectedly in September and builders' gloom had lifted slightly, the painful truth is that America's housing adjustment probably has a lot further to go.

The effect of that adjustment on Americans' spending has yet to be felt. So far, the housing bust has hit builders most. America's GDP growth slowed to a crawl over the summer as builders cut back. Consumers have barely noticed, mainly because unemployment remains low and tumbling fuel prices have boosted their bank balances and buoyed their spirits. Petrol prices have fallen by almost 30% over the past two months. The strength of consumer spending has led many economists to argue that America is headed for a soft landing. Perhaps, but as the housing bust deepens, even the most spendthrift Americans will keep a tighter grip on their wallets. America may avoid recession, but it won't avoid a slow-down. Will it drag the world economy with it?

The reason it will not is that the common view of the American consumer as the engine of the world economy is flawed. IMF figures show that Asia, not America, has been the main driver of global demand, powering the world economy through its fastest five-year period of growth since the early 1970s. That is not just because Asians are producing so much more, but also because they're buying so much more. Asian consumers are on a spending spree, splashing out on anything from mobile phones to designer clothes.

They know how to spend

Asia is the world's fastest-growing consumer market. The IMF forecasts that total household spending

there will rise by almost 7% in real terms this year. In comparison, the 3% growth in American consumption looks almost parsimonious. Although America's consumer spending is still larger than the whole of Asia's in current dollars, the growth in Asian spending this year will be half as big again as that in America. Asia's consumer market already exceeds America's if converted at purchasing-power parity (which makes sense, because housing and domestic services are much cheaper in poorer countries, leaving more of a given sum to spend on consumer durables and the like). No wonder Wal-Mart, the world's biggest retailer, is eager to expand in China. This week it agreed to buy the country's second-largest hypermarket chain. International retailers are battling to get a stake in China as rising living standards and rapid urbanisation create masses of new consumers. On today's trends, the consumer market there, measured in PPP, will overtake America's by 2020.

Economists, who tend to be less excitable than retailers, point out that Asian consumption levels are still fairly low. In Asia, household consumption accounts for only around 55% of GDP on average, compared with 71% in America. But it is the pace of the increase in consumer spending as much as its share of GDP that determines overall growth. And the lower consumption's current share of GDP, the more scope there is for it to grow.

Still, however bouncy Asian consumers are feeling, slowing growth means that America will buy fewer goods from the rest of the world. So the big question is how much the rest of the world depends on exporting to America. And the answer is: less than is generally thought. Smaller Asian economies, notably Taiwan, are heavily export-dependent. But the bulk of growth in China, India and Japan in recent years has been driven by domestic demand (see article).

It is true that China runs a large current-account surplus with America and rising net exports have contributed almost two percentage points of China's growth over the past year, but even without that boost, China's GDP growth would still have been an impressive 8.5%. Moreover, America is not the only importer. Indeed, its share of world imports has fallen from 21% to 16% over the past five years—further proof that demand is strong elsewhere. If America imports less, Asia's GDP growth will slow, but by less than doomsters predict.

Buoyant Asian demand should help keep Europe afloat, too, for European exporters are a lot more dependent on Asia, and a lot less dependent on America, than they used to be. Exports to Asia last year were €244 billion, €44 billion higher than in 2001. Those to America were, at €185 billion ($230 billion), only a little more than they were four years ago.

Europe cheers up

European demand should also do its bit for the world economy. Europe's recovery is not, as is widely held, purely export-driven. Most of the euro area's current growth comes from domestic demand, as spending by firms and households has perked up. Third-quarter GDP figures are likely to show the euro-area economies outpacing America's for a second consecutive quarter. The euro zone has a reasonable amount of spare capacity, which could allow it to grow above trend for a few years. And European consumers have not been as profligate in recent years as American ones, so they have the scope to reduce their saving and spend more. As a result, the euro area is likely to make a bigger contribution to global growth over the next few years than it has of late.

Asia's growth has changed the global economy in a lot of ways, mostly for the better. One of them concerns the rest of the world's vulnerability to the vagaries of the American economy. In the past, American recessions meant global recessions. But this time round, even if America drops sharply, the world won't stop.

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Iraq

Between staying and going

Oct 19th 2006
From The Economist print edition

A search for new ideas should not blind Americans to the stark choice they face in Iraq

AP

LIKE a hanging, the approaching mid-term elections are concentrating minds in Washington. Republicans and Democrats are racing to find some new idea to rescue America from the quagmire of Iraq. Until now, the policy of George Bush has been to stay the course, come what may. But what if the only alternative to cutting and running is staying and failing?

So far, relatively few influential voices are calling for an immediate withdrawal. But the numbers are growing, and this is a worry. For the likely result of an American flight would be to make the present horrors worse.

From insurgency to civil war

There was a time when most violence in Iraq was the result of a Sunni insurgency against the foreign occupiers. If the occupiers left, or so the argument went, so would the reason for fighting. However, most of the killing is now part of a sectarian war between Sunnis and the Shias. The unpopular Americans are almost the only force keeping this killing under some control, and their going could spark a fight to the finish.

Some people argue that a short and decisive battle for supremacy would in the end cause less suffering than the protracted one now raging under America's nose. But there is no reason to expect such a battle to be short. If America with more than 140,000 soldiers cannot subdue the Sunni minority, why expect the largely Shia government forces to do better? The likelier prospect would be a long war that sucked in neighbours (Turkey, Syria, Iran and Saudi Arabia are all candidates). That is what happened in Lebanon's civil war, but there the stakes were lower.

Given the unappetising prospect either of staying the course or leaving at once, Americans long for a middle way. Why not split the country into Shia, Sunni and Kurdish statelets? Instead of going right now, why not set a timetable, to galvanise the warring parties to settle their differences before a free-for-all? One far-fetched idea from the Iraq Study Group, a bipartisan team looking at alternatives on behalf of Congress, is said to be to withdraw “over the horizon” and control Iraq from a neighbouring country. Another is for America to be less fastidious about establishing democracy, and concentrate on the smaller

aim of establishing a government that works.

It is no bad thing to explore new ideas. The trouble is that none of these examples stands up to scrutiny.

Take partition. This is not a mad idea. A case can be made that Britain's creation in the 1920s of a single political entity called Iraq was a failure from the start, and that the only thing that can hold it together is an iron fist like Saddam Hussein's. So if the choice is between another dictatorship or endless civil war, partition begins to look attractive. If not a mad idea, however, partition is a bad idea. It would be neither neat nor bloodless: Kurds, Shias and Sunnis are intermingled in many areas, including Baghdad. And the precedents are awful. In Palestine, India and Yugoslavia partition led not just to war and forced migration but to a series of wars. And there is, again, the complication of neighbours. Independence for the Kurds is anathema to Turkey and Iran. A Shia state on its border, adjacent to where its own restive Shias live, would horrify Saudi Arabia. And what would the Sunnis in Iraq's centre gain once partition cut them off from Iraq's oil riches?

As for America being less fastidious about democracy, this sounds commendably realistic. Iraqis living in daily fear of murder certainly have bigger things to worry about than a low score from Freedom House. The snag is that even if it seemed briefly possible after the fall of Mr Hussein to impose a friendly strongman in his place, that looks out of the question now. Having tasted democracy and voted in their millions, Iraqis will not be so easily cowed again by one man from one group. The present policy—hammering out a power-sharing agreement between elected groups—may be challenging but is more realistic than a belated quest for dictatorship lite.

On closer inspection, in fact, many of the competing ideas masquerading in Washington as big new ideas turn out to be small refinements of the existing policy. One such is the idea for partition lite—a federal arrangement with a weak centre and strong regions. That is pretty much what the existing constitution allows and is already the subject of fierce negotiation between the parties. A more genuinely new idea is for America to seek a reconciliation with its foes in Syria and Iran, in the hope that the active involvement of these powers will somehow stabilise the country. But this smacks of desperation: Iran is already deeply engaged in Iraq, on the side of the Shias. That is exactly what enrages and frightens the Sunnis.

Not wrong, just very, very hard

At the end of the day, the three-pronged policy America is already pursuing in Iraq may very well be the best of a bad lot. Stated briefly, this consists of trying to keep the lid on the violence, build up Iraq's own security forces and prod Iraqi politicians into making a power-sharing deal. Each prong has faced harder resistance than expected. Violence is widespread, Iraq's new police force is riddled with sectarianism (the army is a bit better), and in the political negotiations the Sunni minority and Shia majority have not yet found a way to adjust peacefully to the reversal of their respective political fortunes. If America is willing to stay the course for a few more years, success is still possible—though the policy will continue to be costly in American lives and money.

The only honest alternative is indeed probably just to go, and let one side win. America did that in Vietnam and Britain did it in Palestine. After much suffering, Vietnam turned out well enough, regional dominoes did not all fall, and America went on to win the cold war anyway, not least because communism was a nonsensical and unloved system and the peoples on whom it had been foisted were eager to ditch it. Maybe something similar will happen in Iraq, not least because the rival versions of theocracy on offer from Iran and al-Qaeda are nonsensical too. But just going would be a fantastic gamble, not only with America's global power and prestige but also with other people's lives. Better, still, to stay.

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The City

How to protect an industry

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The City's success shows that exposing it to foreign competition is the way to do it

Reuters

AT ANY half-decent lunch in the City of London a few decades ago the cabbage was overcooked and the conversation was about cricket. Today's financiers eat their brassica puréed, with seared scallops and a cumin *jus*, while chatting about the property they own back home in the Auvergne or New England. And they—and the businesses that pay their wages—are wealthier and more successful than ever.

Britain's most lucrative industry owes its dynamism to many things, including globalisation, innovation and the good fortune to be based in an old imperial trading city that sits handily between Asia and the Americas. But there was nothing pre-ordained about London's success as a financial centre: it happened largely thanks to an inspired piece of state intervention 20 years ago that opened the doors to foreign talent and foreign capital.

Square guile

On October 27th 1986, pressed by Margaret Thatcher's government, the City blew apart the closed shop of the London Stock Exchange in a reform known as Big Bang (see article). Out went minimum commissions and other restrictions, and in came a stampede of foreign firms. The government stood by and watched as they swallowed the old British firms that had previously dominated the City.

The new financial aristocrats don't wear old school ties. Many don't wear ties at all. People have brought talents and tastes from the four corners of the globe. The ethos is American: what you know matters more than who you know.

The results are hard to argue with. London has kept its long-standing dominance of foreign-exchange trading; its share of the market for over-the-counter derivatives has increased from 27% in 1995 to 43% in 2004. A fifth of the world's hedge-fund assets (including 80% of Europe's) are managed out of London, compared with a tenth in 2002. Though London's insurance market has suffered from tax competition, the City has powered ahead in services such as the law and ship-broking. In equities, the business Big Bang was designed to secure, London has hosted 172 international listings so far this year, compared with 134 in regulation-bound New York.

There are threats, of course. This week the two Chicago derivatives exchanges merged to create the

world's largest futures exchange (see article). There is a constant danger of over-regulation, either after the next scandal or from the European Union, which is tempted to burden wholesale markets with regulations designed for the small investor. And London's transport system is dismal and its property overpriced.

Yet Britain's politicians understand—or at least they say they understand—what the City needs. This week they have been queuing up to announce pro-City taskforces and reforms. The recipe is as straightforward in principle as it is hard to provide in practice: open industries to new talent and expertise and to constant innovation, and regulate lightly. Get it right, and clusters start to grow. Financial markets are a striking example of how buyers and sellers of skills and know-how crowd together; but the effect has worked in Britain in other industries, too, such as carmaking and design.

This is the lesson of Big Bang: to protect an industry, sacrifice your national champions. That brave decision 20 years ago brought wealth, jobs and cosmopolitan buzz to a once-sleepy City, and banished the overcooked cabbage for ever.

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Turkey

Is the West losing Turkey?

Oct 19th 2006
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Repair work is needed to mend a deteriorating relationship

Getty Images

THE relationship between Turkey and the West has always been awkward. The age-old hostility between the rising Muslim empire of the Ottomans and the declining Christian one of Byzantium still casts a shadow—as the pope discovered when he unwisely quoted a Byzantine emperor's negative views of Muhammad. So it is no surprise that tensions should arise between Turkey and the European Union, or between Turkey and America. What is worrying is that, at a moment when these two relationships matter more than ever, both have simultaneously deteriorated.

Turkey is important to the Americans and Europeans for geographical reasons: it abuts the EU to its west and the Caucasus, Iran, Iraq and Syria to its east. It matters for economic reasons: fast-growing GDP and a rising population have made it an important trade and investment partner. It is significant militarily, with the biggest NATO army after America's. But it counts above all as the best exemplar of a mainly Muslim country that is a thriving democracy and a secular republic—a rare beast that the West desperately needs to encourage.

Yet Turkey's relations with the United States have been testy ever since its parliament blocked the passage of American troops to Iraq in March 2003. Now the Turks are simmering because they say the Americans have done nothing to stop Kurdish PKK fighters, who have resumed guerrilla and terrorist activities in Turkey's south-east, basing themselves in the northern Kurdish area of Iraq. The public mood in Turkey has turned hostile to America: in one poll this summer, more Turks had a good opinion of Iran than of the United States.

Ordinary Turks have also become more negative about Europe. In December 2004, when the government of Recep Tayyip Erdogan won the promise of an opening of negotiations to join the EU, the reaction across Turkey was euphoric. But the talks have progressed painfully slowly. The perception in Ankara is that the EU is piling on big demands—for constitutional change, economic liberalisation, more religious tolerance—but offering little in return. Over the past two years a stream of leaders from such countries as France, Germany and Austria have made clear that they are against Turkey ever joining the EU. And now Brussels is threatening to suspend the entry talks unless Turkey fulfils its promise to open its ports and airports to the (Greek) Republic of Cyprus, although the EU's effective embargo of northern Cyprus will remain (see article).

In such a climate, even small gestures can be damaging. The bill just approved by the French National Assembly to make it a crime to deny the Armenian genocide of 1915 seems unlikely ever to become law.

But it has created a storm of protest in Turkey, which has never acknowledged the genocide. In the run-up to next year's election in Turkey, Mr Erdogan, who leads the mildly Islamist AK party, is understandably inclined to pander to nationalist (and religious) feeling. Yet he is playing with fire: radical Islam is gaining fresh recruits, and mutterings can be heard in the Turkish army, which has a long history of interfering in politics, about its duty to protect the secular tradition of Ataturk.

Build up, don't knock down

Some in Washington might welcome a military intervention if it produced a more compliant ally. But it would be a huge setback in the impressive progress that Turkey has made under Mr Erdogan. He would do well to continue that progress, by returning to the goal that he first chose in 2003: to prepare Turkey for joining the EU. That also requires a new engagement by the Europeans. Rather than speaking out against Turkey's eventual membership, EU leaders should let the negotiations proceed without prejudice to their outcome. The current Finnish presidency of the EU also deserves strong support in its efforts to find a compromise that averts the “train-wreck” over Cyprus which threatens to scupper the talks. Both America and Europe must pay closer attention to Turkey in the next few months if they are to avoid the risk of losing it.

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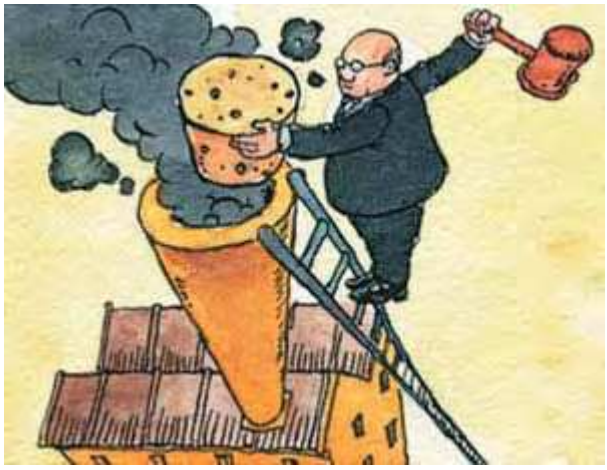
Carbon emissions

Terminating greenhouse gases

Oct 19th 2006
From The Economist print edition

What Europe's failing effort to cut carbon emissions can teach California



AMERICA'S greenest governor, Arnold Schwarzenegger, announced on October 16th that he was planning to set up an emissions-trading scheme between California and other states to try to curb the output of greenhouse gases. Given the complexity of designing and operating such schemes, it is fortunate for Mr Schwarzenegger that Europe already has one up and running; for it offers valuable lessons in what not to do.

Europe's Emissions-Trading Scheme (ETS) was one of the few substantial developments to emerge from the wreckage of the Kyoto Protocol. Its purpose was threefold: to cut emissions; to get polluters to pay for the damage they cause; and to get industry to invest in cleaner technology.

Under the ETS, countries set national targets for emissions and give 13,000 factories and power plants in Europe's five dirtiest industries allowances to emit a certain quantity of carbon. If companies want to emit more than their limit, they have to buy either extra allowances from other plants, or credits from plants in the developing world that have cut their emissions. This trade in allowances gave birth to the carbon market. It is sizeable and growing fast: in the first half of 2006, carbon to the value of €12 billion ($15 billion) was traded, five times more than in the same period in 2005. The idea was to screw allowances down over time, thus raising the price of emitting carbon.

Unfortunately, the ETS has failed in all its three aims. Emissions were flat before the scheme's introduction in 2005 (largely because manufacturing is moving out of Europe); have been flat since; and, if the European Commission accepts the national plans for handing out allowances put forward for the 2008-12 phase of the scheme, will continue flat. With so many allowances on the market, the price of carbon credits may well collapse and the carbon market fade away.

Nor are polluters paying—rather the reverse. In order to get industry to swallow this scheme, allowances were handed out free to companies, rather than being (as economists wanted) auctioned. In power-generation (Europe's most-polluting industry) companies passed the price of carbon credits on to customers and pocketed the value of the allowances. According to a report by IPA Energy Consulting, Britain's power-generators alone made a profit of around £800m ($1.5 billion) from the scheme in its first year.

Lastly, the ETS is not leading companies to invest in greener technology. In power, for instance, there

has been a boom in coal-fired generation—the dirtiest sort. That is largely because of high gas prices; but the ETS has not been a countervailing force, chiefly because its time-horizons (2005-07, then 2008-12) are too short for companies to factor the cost of carbon into their investment plans.

California would be wrong to conclude from Europe's experience that emissions-trading schemes cannot work. But, as America's successful campaign to cut emissions of sulphur and nitrogen oxides showed, such schemes need to have longer time-horizons and less generous allowances to industry.

As for Europe, it needs to think again. In the short term, the commission, which is due to rule on countries' allocation plans next month, should slash them. In the longer term, the scheme needs to be redesigned. Europe's governments like to think of themselves as the world's greenest; but if they nurture a carbon market only to let it wither and die, they will do their cause more harm than if they had never tried.

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On Ban Ki-moon, Airbus, technology leapfrogs, Romania, Nepal, atheism, habeas corpus, the Nobel Peace Prize

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From Economist.com

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FAX: 020 7839 2968 E-MAIL: letters@economist.com

Diplomatic exchange

SIR – Ban Ki-moon may well be called an "administrative clerk" in his native South Korea ("Enter Mr Ban", October 7th). And as he becomes the United Nations' new boss some may think he will be more secretary than general. Yet this ambiguity about the limited role of the head of the UN is instructive. One should recall that Dag Hammarskjold was initially perceived to be a mild-mannered Scandinavian functionary who did not even apply for the job before he was lauded as an effective internationalist. However, Hammarskjold was also declared *persona non grata* by the Soviets for "losing" Congo to the West, chastised by the Americans for exceeding his authority, and rejected by the French for his active anti-colonialism. Mr Ban will have to conduct diplomacy in a similar international bear-pit and mobilise the UN pulpit to continue the work of Kofi Annan (who has received his own share of criticism during turbulent times) to promote human rights, lead humanitarian interventions and fight diseases. Balancing the representation of all member states and avoiding a major conflict with powerful nations is a delicate act. Mr Ban will need a lot of energy in his new job, as well as a lot of good luck.

Yves Beigbeder
Thonon les Bains, France

Leadership qualities

SIR – Your article on Airbus provided a very clear outline of the fundamental issues facing the aircraft-maker ("The airliner that fell to earth", October 7th). However, the specifics of the situation in which Airbus now finds itself are partly the responsibility of previous management. Noël Forgeard, who was ousted in June as co-chief executive of EADS, Airbus's parent company, personified the arrogance and sense of entitlement of the French "elite". Graduating from the *grandes écoles* can signal a superior cognitive intelligence and obviously helps foster high-level relationships, but it is no substitute for practical leadership. The severity of the plight that EADS and Airbus are in today should be enough warning that the cosy French model has reached its limitations.

Jean Claude Noel
Adjunct clinical professor
INSEAD Global Leadership Centre
New York

Walk before you can run

SIR – After reading your leader on technology leapfrogs one should not conclude that it makes sense for developing economies to jump "from agriculture straight to high-tech industries" ("Behind the bleeding edge", September 23rd). Granted, such jumps may be productive at the level of single commodities, but countries with large agricultural sectors containing significant surpluses of labour, including India, which you cited as an example, cannot afford to skip past a development phase of unskilled labour-intensive industries and low-tech services if they are not to experience diminished growth and a level of income distribution with dire poverty consequences.

Gustav Ranis
Frank Altschul Professor Emeritus of International Economics

Yale University
New Haven, Connecticut

Looking after the kids

SIR – I was impressed with your tough-but-fair evaluation of Romania and Bulgaria as they prepare to join the European Union ("We're off on a European Odyssey", September 30th). Both countries have made great progress and should be welcomed into the EU even though they still face tremendous challenges, particularly in their legal systems. Romania also needs to put more effort into its health and education sectors and corruption remains a significant problem there. However, there is one area of reform where the country has made great strides: child welfare. The Romanian government has reduced the number of children in establishment care by stopping the institutionalisation of infants and built up the biggest network of foster carers in eastern Europe. Although still in development, and while there is still much to do, these child-welfare reforms are the most significant in eastern and central Europe.

Baroness Nicholson of Winterbourne, MEP
Vice-chairman, Foreign Affairs Committee
European Parliament
Brussels

Juries out in Nepal

SIR – It was wrong to give the impression that the mushrooming of Maoist-run "people's courts" in Nepal are making the rebels stronger ("Judged by the people", October 7th). Firstly, such courts are not new; social courts, or *panchayats*, have a long history in the country. Before the Maoists began their courts, *panchayats* were very popular, particularly in Nepal's fertile south where most land-related disputes are generated. Secondly, if the Maoists are popular it has little to do with the charisma of Prachanda, the rebel leader. Given the arrogance of the king (who thinks he is a maharaja) and the incompetence of the parties, I also prefer Comrade Prachanda. Not because I like him, but because there is little choice. The rebels are not getting stronger; they are just less frail than the other options.

Sameer Ghimire
Sydney

Thinking man

SIR – The Marqués de Tamarón used an old and easily refuted argument in his attempt to defend religious faith against atheism by pointing to the godless regimes of communism and National Socialism (Letters, October 7th). He should have considered that Stalin's regime (like that of China under Mao) was based on a personality cult, and that Nazism was underpinned by a warped Nordic mythology and ideology centred on an Aryan master race. These cultish, quasi-religious qualities have little in common with atheism. Atheists believe that rationality and critical thinking serve humanity better than blind faith and religious dogma. The regimes of Hitler, Stalin and Mao did not come into being in order to defend atheism. And the horrors of communism and Nazism occurred not because these societies applied too much reason and critical thinking, rather because they did not apply enough.

Mark Eaton
Vancouver

Trying times

SIR – You mentioned that even some Republicans are troubled by the suspension of habeas corpus for terrorism suspects in new legislation ("Cold comfort", October 7th). This right, as you acknowledged, is traced back to 1215 when King John signed the Magna Carta, an event which American law marks as the base of its foundation. The king signed the document at Runnymede, and in 1964 Queen Elizabeth II ceded part of the meadow to America in perpetuity as a memorial to the recently assassinated John Kennedy. The United States is nothing if not its constitution and laws. It has taken nearly 800 years, but we have returned to a state of executive fiat whereby some people's right to challenge their detention can be dismissed at the government's caprice. King John must be smiling; John Kennedy is certainly not.

Randal Roman
Aptos, California

Defining peace

SIR — Your backhanded congratulations to Muhammad Yunus for winning the 2006 Nobel Peace Prize are surprising and reflect a narrow interpretation of peace ("Losing its lustre", October 13th). Comparing individual or group contributions across countries is always difficult and certainly the achievements of recipients such as the Red Cross might dwarf those that have a more local impact. But do all winners need to have contributed to ending warfare? Mother Teresa won the prize in 1978, to widespread acclaim. Gandhi said "Poverty is the worst form of violence." Mr Yunus's vision of microfinance has spread worldwide and helped millions of poor people.

Rahul Tongia
Pittsburgh

SIR — Peace is not just the absence of war but the absence of hunger, poverty and fear. It is when people are free to choose what they want for themselves and their families. In this sense Mr Yunus and his bank are one of the worthiest winners in past years.

Philipp Lichterbeck
Berlin

SIR — At the heart of Grameen's programme is the goal of building dignity among peoples who often have nowhere else to turn. This model has proved successful in many parts of the world and provides hope in others, such as the impoverished, war-torn, terrorist breeding ground of Mindanao in the Philippines. What could be more deserving of a global-peace award?

Nereus Acosta
Congress of the Philippines
Co-founder, Binhi-Bulig Grameen Microfinance Project
Bukidnon, Philippines

SIR — Mr Yunus and Grameen should have been granted the Nobel award for economics. The work of spreading microcredit through the developing world has improved millions of lives. And this contribution to development in the real word is likely to be of far greater importance than that of any ivory-tower theorist.

Lee Shephard
Oakland, California

SIR — I visited a Grameen-inspired microcredit programme in a huge violence-wracked slum outside Bogota. I asked one of the women participants how her loan had helped her. "My husband no longer beats me" was the unexpected reply. "That's true", chimed the husband. The whole family dynamic, placed under stress by dislocation and dereliction, had been transformed by the confidence that one woman had built from joining with other women to address their needs through microcredit. Peace had been restored within the family and a new life is being built from the ground up. If that does not merit the Nobel Peace Prize, I cannot imagine what does.

Nicholas Colloff
Alcester, Warwickshire

SIR - You wrongly suggest that anti-poverty campaigners are different from peacemakers. Giving impoverished women financial power is more courageous than any wartime peacekeeping negotiations. The violence and hardship that Grameen's operations alleviate makes it a worthy winner.

Heather Buck
New Orleans

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The Arab world

Coalitions of the unwilling

Oct 19th 2006 | CAIRO
From The Economist print edition

Resistance to the West, and rejection of Israel, are the pillars of a rapidly strengthening alliance in the world's most volatile region

AP

Get article background

THE Middle East is no stranger to doom and gloom. The most enduring conflict of the past century, between Israelis and Palestinians, drags on drearily today. The first wars of the 21st century have also unfolded there, in Afghanistan, Iraq, western Sudan and Lebanon.

This being so, the West has a long history of espying new spectres in the region. In the 1950s and 1960s it was Nasser, Egypt's passionate pan-Arabist leader. In the 1970s it was Palestinian terrorism; in the 1980s Khomeini's Islamic revolution; since the turn of the century, al-Qaeda-style mayhem; and now again revolutionary Iran, newly expansionary and perhaps, some day, armed with nukes.

Some of these imagined threats to the global order have been leftist and nationalist, some reactionary and religious, some radical and violent. Yet all have drawn their mobilising power from a single source. They have all been, in essence, resistance movements, inspired by a seemingly unquenchable popular urge to challenge the dominant perceived injustice of the day, whether it be European colonialism, Zionism, American hegemonism or the grip of local governments charged with selling out to the West.

The most reliable populist cry today remains “resistance”. Sudan's strongman, Omar al-Bashir, blasts the proposed deployment of UN troops in Darfur as the spearhead of a new Western crusade. The Shias and Sunnis in Iraq may be fighting each other for dominance, but the call to “resist” the American occupiers and the weak (though elected) government they sponsor wins passionate followers to both camps. Hizbullah rouses region-wide cheers for bloodying Israel's nose. Clearly, although times have changed, this dynamic has not.

What has changed is that the call to resist now inspires unprecedented enthusiasm, galvanising many disparate political streams at once, secular and nationalist as well as Islamist. The religious element, boosted by the great revival that has swept Muslim societies across the globe, adds a scriptural drumbeat to the call. And lately the impulse to resist has also been strengthened by the failing prestige of

traditional countervailing forces—America, the moderate governments in the region and the liberal-minded minority of their citizens.

The most obvious sign of the renewed attraction of resistance is the strengthening of a rejectionist front built around the alliance between Iran and Syria. The bond between these countries' very different regimes—one ostensibly secular and Arab nationalist, but in fact an insular, sectarian dictatorship, the other a Shia theocracy—goes back a quarter-century. It was forged in opposition to their mutual neighbour, Iraq, then under the belligerent fist of Saddam Hussein. But the scope of this odd couple's shared interests widened over time. It came to include such goals as keeping Lebanon under Syria's thumb, undermining peace moves between Israel and the Palestinians so as to pressure Israel into disgorging the Golan Heights, occupied in 1967, and making sure America burned its fingers so badly in Iraq that the superpower would not think of similar adventures elsewhere. The Syrian-Iranian alliance also embraces smaller clients who share these goals, such as the main Islamist parties championing “resistance” in Lebanon and Palestine, Hizbullah (the Party of God) and Hamas (which means “zeal”, but is, revealingly, an Arabic acronym for Islamic Resistance Movement).

Not so long ago, this ungainly partnership was faring poorly. In 1997 Iranians elected a liberal-leaning president, Muhammad Khatami, who seemed intent on shedding his predecessors' confrontational stance. In early 2000, Syria came close to making peace with Israel. (Very close indeed: the actual area of the Golan Heights that remained disputed was a 150-metre-wide strip.) Though hailed as a victory by Hizbullah, Israel's unilateral withdrawal from southern Lebanon that spring put into question the need for continued resistance by Lebanese guerrillas. At Camp David that summer the Palestinian issue looked set for a resolution that would have rendered quaint Hamas's stated aim of destroying the Jewish state.

The Iraq factor

The past few years have reversed all these trends. The collapse of the Camp David summit and the eruption of a second, far more violent *intifada* radicalised the Palestinians, with the result that elections in January of this year produced a landslide for Hamas. Disappointed by the failure of American peace brokerage and America's drift, under the Bush administration, into ever more solid support for Israel, Syria reverted to putting pressure on its Israeli adversary by other means, such as supplying huge numbers of rockets to its Lebanese client, Hizbullah, and offering political sanctuary to Hamas. Radical conservatives in Iran, meanwhile, outmanoeuvred fractious liberals to secure the election, in June 2005, of Mahmoud Ahmadinejad, a hardliner, as president. The supreme leader of Iran's revolution, Ayatollah Ali Khamenei, who masterminded this coup, quickly proceeded to accelerate the country's nuclear programme.

But it was, above all, American policy that boosted the rejectionist alliance. Seeking targets to retaliate against after September 11th, the Bush administration chose to focus on what it labelled “state sponsors” of terrorism. It also lumped together groups such as Hizbullah and Hamas, whose chief agenda was local and nationalist and did not threaten America, with the global terrorist network of al-Qaeda, which had not only declared war on the superpower and on “Jews and Crusaders”, but had also launched hostilities in the most dramatic fashion conceivable.

In May 2002 the administration added Syria to its “axis of evil” (originally Iran, Iraq and North Korea). This seemed odd at the time, since Syria was providing America with useful counter-terrorism intelligence, and Iran had played a helpful role in the overthrow of the Taliban in Afghanistan. In 2003 America rebuffed a back-channel Iranian effort to start a dialogue, and later that year slapped sanctions on Syria. “We would have been happy to play the game with them,” sighed a Syrian official at the time. “But they wanted all our cards with nothing in return.”

America's invasion of Iraq, meanwhile, produced a cascade of responses that bolstered the resistance front. The intrusion threatened to drive a physical wedge between Iran and Syria, and so reinforced their mutual need. It emboldened Iraq's Kurdish minority, so raising fears of unrest in Syria's and Iran's own oppressed Kurdish regions. Yet it also empowered the long-disenfranchised Shia majority, a natural bridgehead for Iranian influence. And obviously it removed Saddam Hussein's army, the main military obstacle to the projection of that influence farther afield.

Far more important, the invasion massively buttressed the old rejectionist thesis that America's aim was to divide and rule the Muslim world, to control its oil and to impose Western culture. Here, stirring faded memories, was a Christian army overrunning a Muslim land, in pursuit of what George Bush once carelessly called a “crusade” against terrorism. And here, on the ground, was “resistance” in action, visibly humiliating the intruding warriors.

In this potent narrative of victimhood Israel, of course, has been held up as a prime example of Western malevolence. But Israel's recent war with Hizbullah added rich fuel. Hizbullah may have provoked the war, but that counted little to the Arab world's television audiences. The tenacity of Hizbullah fighters in defence of their villages added to the lustre of resistance. America's foot-dragging diplomacy, and the hypocritical aloofness of the “moderate” Arab leaders of Saudi Arabia and Egypt, who clearly hoped privately for Hizbullah's defeat, seemed to substantiate charges of complicity in the killing.

So entrenched now is the idea of an American-led assault on Muslims that virtually any new development is immediately enlisted as further evidence. The fact that terror attacks on Westerners, carried out in the name of Islam, may have raised some hackles goes without mention. So does the fact that countries such as Syria, under the cloak of resistance to the West, continue to promote agendas in Lebanon and elsewhere that have nothing to do with anti-Americanism, but with cementing their own regional influence.

Even high-minded Western initiatives now arouse suspicion. The effort to deploy a tougher peacekeeping force in Darfur, where some 200,000 people have been killed and perhaps 1m displaced by a government-assisted slaughter of Darfuris, is widely seen as a subterfuge. The head of the Egyptian lawyers' union, a group which might be expected to defend the rights of the weak, recently declared that the true target of UN peacekeepers was Egypt: Sudan was simply “the next stop after Iraq on the road to the heart of Cairo”.

The manner of the ceasefire in Lebanon aroused scepticism, too. To many, the insertion of a UN peacekeeping force was aimed at recouping by diplomacy what Israel had lost by fighting. A recent poll found that 84% of Lebanese believe the war was “a premeditated attempt by the United States and Israel to impose a new regional order in the Middle East”. As for the international siege of the Palestinians until they renounce terrorism and accept the right of Israel to exist (see story), the popular

perception is that the West, having claimed to support democracy, is now punishing Palestinians for having elected Hamas in a fair vote.

The shadow of Iran

In the popular mind, attempts to curb Iran's nuclear ambitions also mesh neatly with the narrative of Western powers holding back Muslims, or applying double standards. Why can't Iran have nukes if Israel can? Iranian diplomats ably exploit such doubts. So do a growing number of fellow-travellers in regional politics, such as the Muslim Brotherhood, the Egyptian Islamist group whose ideological offshoots include Hamas and the main opposition movements in American-allied Morocco, Jordan, Kuwait and Yemen. “Any country should have the right to obtain nuclear technology or even nuclear arms for deterrence, especially if it is being threatened by another nuclear country,” says the Brotherhood's deputy leader, Muhammad Habib.

Such overt support from the most influential Sunni political grouping is telling. Clearly, Iran's vociferous backing of resistance movements has done wonders—outside Iraq—to heal the age-old rift between the two main branches of Islam. Elsewhere, the example of Hizbullah has—among ordinary citizens, at least—largely dispelled looming fears, first voiced by Jordan's King Abdullah, about the emergence of a “Shia crescent” from the Mediterranean to the Persian Gulf where Iranian mullahs might call upon millions of minority Arab Shias to rise up against Sunni Muslim dominance. Lebanon's Shia resistance has provided what one senior Western diplomat calls a new political paradigm: “an Arab party that actually means what it says and does what it promises.”

Ayatollah Khamenei, brandishing a Kalashnikov and speaking in his fluent classical Arabic in a Friday sermon on October 13th, put the matter more bluntly. Blasting critics of Hizbullah as “cringing hirelings of the Great Satan”, he said that the Iranian-funded militia's victory had made the group so loved that Muslims everywhere felt they had participated in it. The claim is not far-fetched. In far-off Brunei, by the South China Sea, the sultan issued orders for the obligatory performance of special prayers for Israel's defeat. In Egypt, a solidly Sunni country ostensibly allied to America, the two most popular politicians, according to a recent survey, are the Hizbullah chief, Hassan Nasrallah, and President Ahmadinejad of Iran.

Reuters

Khamenei with Kalashnikov

Understandably, such evidence of a powerful mood-swing on the Arab “street” dismays and alarms pro-Western Arab leaders. It is not simply that the governments of countries such as Egypt and Jordan, which long ago settled their own problems with Israel, fear renewed public pressure to resume “resistance” (ie, war), which is what the Muslim Brotherhood promises if it comes to power. These American allies are hostile to Hizbullah because the group provides a dangerous example of a potent non-state actor armed and supported by neighbours. They abhor the Syrian regime, blaming it for meddling (and murdering) in Lebanon and for undermining efforts to persuade Hamas to recognise Israel. They are spooked by Hamas's electoral success and the possibility of Islamist encroachment much closer to home. The Muslim Brotherhood made impressive gains in Egypt's parliamentary elections last year, and is expected to do equally well in Jordanian polls scheduled for 2007. Morocco, another American ally, also faces elections next year, with analysts predicting a shoo-in for the Islamist opposition.

America's shaky friends

As for Iran, Egyptians have never forgiven its revolutionary leaders for naming a Tehran street after one of the assassins of their peacemaking president, Anwar Sadat. Lebanon's shaky governing coalition, now in a stand-off with Hizbullah, sees Iran as the main obstacle to a deal under which Hizbullah might focus on being a political party and give up its arms. Gulf states feel a more direct threat, since many of them host American military bases.

The rulers of archly Sunni and conservative Saudi Arabia, in particular, have long viewed Iran as a dangerous rival. In the 1980s they blamed it for stirring unrest among the kingdom's large Shia minority, and in response helped bankroll Saddam Hussein's war against the Islamic Republic. During the recent Israel-Lebanon war, when some Saudi youths made the mistake of sticking posters of the admired Mr

Nasrallah on their windscreens, Saudi police promptly arrested them.

The Bush administration has belatedly tried to rally its allies and to bolster such beleaguered figures as the Palestinian president, Mahmoud Abbas, and the prime ministers of Lebanon and Iraq. But the response has been half-hearted. This loose collection of accommodationist governments is finding it hard to gain traction against the resistance ideal. One problem they face is Israel, whose increasingly harsh operations against Palestinian fighters in the West Bank and Gaza have made it more toxic than ever. Israeli and Arab moderates both want to cool temperatures over Palestine and Lebanon and to contain Iran. But Arabs are uneasy at any hint of an alliance with the Jewish state.

America's own refusal to engage directly with the resistance block has polarised and complicated the situation. Discomfort with America grew particularly acute over the Lebanon war, when countries such as Saudi Arabia were forced, by public outrage at Israel's crushing response, to back away from their criticism of Hizbullah for having started the war.

Yet, although it may lack the rejectionists' unity of purpose and their popular appeal, the accommodationist axis of American friends is not entirely toothless. Gulf countries now have plenty of oil cash with which to win goodwill by, for instance, rebuilding Lebanon and shoring up the Palestinian economy. Such largesse could prove persuasive, too, in trying to coax Syria away from its tight embrace of Iran, since Syria's economy relies on oil reserves that are fast running out.

They might also make progress, with those on the Arab street who are still willing to listen, by posing the question of whether ordinary people really want to sacrifice lives and treasure in an endless fight against Israel. The answer of large numbers of Lebanese during the recent war was a resounding no. Raghida Dergham, a columnist for the Saudi-owned daily *Al Hayat*, writes sarcastically that if what she calls the axis of extremism is resolved on war, “we hope it is ready to liberate Palestine and not exploit the Palestinians as a tool for the ideology and hegemony of others.”

This comment pricks at both Iran and Syria. Few Muslims elsewhere are aware that Mr Khamenei, aside from being supreme leader of the revolution and running the powerful intelligence services, also styles himself Leader of the Islamic World. This suggests a much wider agenda than simple “resistance”. As for Syria, while it champions Islamist liberation movements abroad, mere membership of the Muslim Brotherhood inside the country remains a capital crime.

Arab moderates may be able to convince the Bush administration that the best way to ease tension would be for America itself to be more flexible. That would be wise, because the rejectionist front may not be as intractable as it appears. Syria's president has repeatedly signalled that he would shift his position if only some reward, such as a chance to recover the Golan Heights, were offered. Recent polling among Palestinians shows a similar openness to persuasion.

It is also clear that a powerful sector of Islamist opinion is so fundamentally rejectionist that it will never change. The best the West can do may be to ensure that it does not push more moderates into that camp. It could start by remembering that people choose to “resist” when they feel threatened.

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Moderates and rejectionists

The Palestinian test case

Oct 19th 2006 | RAMALLAH
From The Economist print edition

Pressures on Hamas build from both sides

IN RECENT months the poor Palestinians have, not for the first time, found themselves used as the rope in the tug-of-war between the Middle East's “accommodationist” and “rejectionist” governments. As the Hamas-run Palestinian Authority (PA) totters under the dual pressures of an international economic boycott and increasingly violent clashes with Fatah, its rival, there have been ever more frantic attempts to get the two parties to agree to a unity government that would meet the world's three conditions for lifting the boycott—recognising Israel, renouncing violence and honouring PA-Israel agreements. These attempts have been led by Qatar and Egypt. Pulling the other way have been Hamas's backers, Syria (where Hamas's supreme leader, Khaled Meshal, resides) and Iran.

That tension has gradually divided Hamas in Gaza, where the party is strongest, from Hamas in the West Bank, where it is both weaker and more moderate. The kidnap of an Israeli soldier near Gaza in June, by militants loyal to Mr Meshal, seemed timed to scupper coalition talks between Mahmoud Abbas, the Palestinian president, and Ismail Haniyeh, the Gaza-based prime minister, who after some teetering now seems to have gone firmly over to Mr Meshal's rejectionist camp. Egyptian efforts to negotiate the soldier's release, which some Hamas politicians openly supported, have been torpedoed by Mr Meshal. And now a new proposal, from a broad group of Palestinian intellectuals, politicians and business people, could drive a wedge between the two.

The idea is for an interim government of “technocrats”, approved by the political parties but not drawn from their ranks, to rule for up to a year. It would deal with domestic affairs—the now rampant lawlessness, reform of the PA, and rebuilding the shattered Palestinian economy. Any peace talks with Israel would be left to Mr Abbas in his other role as head of the Palestine Liberation Organisation, the Palestinians' umbrella body. Meanwhile, with the pressures on them suspended, Hamas and Fatah would have a year to thrash out a deal on a joint government.

Rafiq Husseini, Mr Abbas's chief of staff, says this would allow Hamas to give in to the pressure without giving up its “puritanical thinking”. The idea caught on early among Hamas moderates such as Nasser al-Shaer, the deputy prime minister, who is based in the West Bank. Egypt's intelligence chief, Omar Suleiman, has been leaning on Mr Meshal to accept.

However, even if Hamas takes the bait, it knows that unless America and Israel change their stance any eventual unity government will still have to meet the three conditions, or else face a fresh boycott. And, says Mr Shaer, the conditions need to be made “more flexible” for that to happen. “The Palestinians accept international resolutions, signed agreements and a Palestinian state on 1967 land [ie, the occupied territories only], which will all lead to a just peace,” he says. “Why this insistence on details?”

The worry is that the lack of a deal will entrench a de facto political separation between Gaza, run by the Hamas hardliners, and the West Bank, with a more moderate or even a mixed regime. Mr Shaer provided stark evidence of this in an interview with *The Economist*, asking to be identified as a member of the PA government “and not as a member of Hamas”. Such a split would truly render the PA ungovernable, and peace talks impossible.

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Immigration

Don't fence us in

Oct 19th 2006 | PHOENIX AND SAN MANUEL
From The Economist print edition

The debate over illegal immigrants is subtler than it seems

Getty Images

Get article background

“BUILD a fence, they're going to go over it, under it, around it,” declares Jim Pederson to the Democratic Party faithful gathered in the American Legion hall of San Manuel, a drab little town whose miners once carved giant scars into the copper-rich mountains north of Tucson. “Why don't we have a sensible programme?”

In the politics of Arizona, the entry point across the vast Sonoran desert for perhaps 400,000 of the million-odd illegal immigrants who each year smuggle themselves into America, that is a sensitive question. By overwhelming majorities in both House (283-138) and Senate (80-19), Congress ended its pre-election session by voting to build a 700-mile (1,125km) fence along the most vulnerable sections of America's almost 2,000-mile long border with Mexico. Is Mr Pederson, a shopping-mall magnate now vying to be Arizona's junior senator, decrying the notion of border security? Is he, indeed, proposing “amnesty”—the code word that enrages the Republican base across the nation—for the 12m or so illegal residents who help pick America's crops, build its houses, manicure its lawns and baby-sit its infants?

The would-be senator says not: he would hire 12,000 more border-patrol agents over the next five years; use more high-technology to detect border crossings; force the federal government to cover the cost to Arizona of incarcerating foreigners; and punish bosses who knowingly employ illegal workers. But he would also—just like President George Bush and John McCain, Arizona's senior senator (and front-runner to be the Republican presidential nominee in 2008)—set up a guest-worker programme and allow undocumented residents to legalise themselves and glimpse an eventual route to citizenship. As to the “secure the border first” plan of Mr Pederson's rival, Jon Kyl, a two-term senator, “Senator McCain says Jon Kyl's immigration plan ‘borders on fantasy’. My plan's not amnesty, it's realistic.”

The plan also fits neatly into the Democratic playbook for the November mid-term election: do not let the Republicans paint you as “soft” on immigration; instead, attack the Republicans for having allowed illegal immigration to get out of hand, as Mr Pederson says it has in Arizona. Above all, do not let the Republicans use immigration as a “wedge issue” akin to gay marriage.

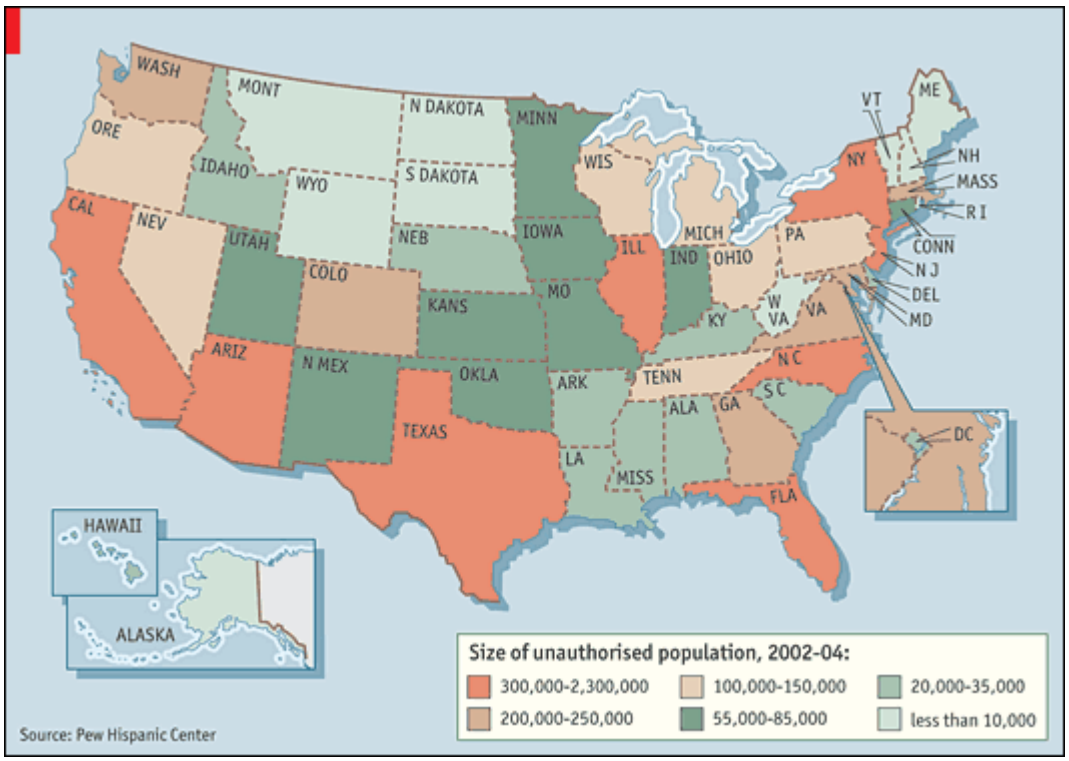
At least on paper, this makes electoral sense. A study by Democracy Corps, a leading Democratic research group, recognises that only 26% of Americans are “warm” to immigration, but claims that “the Democrats are currently favoured over the Republicans on the issue of immigration, and a strong push back on immigration beats a Republican attack accusing Democrats of supporting amnesty.”

Maybe so, and Arizona, which, with perhaps 450,000 undocumented residents in a population of 5.9m, has a higher percentage of illegal residents than any other state, provides some evidence. Janet Napolitano, the Democratic governor, looks to be cruising towards re-election, in part because in August last year she (along with her fellow Democrat, Governor Bill Richardson of New Mexico) defused anti-immigrant anger by declaring a state of emergency on the border. Conceivably, Mr Pederson might even close the gap with the conservative Mr Kyl, an effective but hardly charismatic politician; a recent Zogby poll puts the challenger just seven points behind. Best of all for the Democrats, in the eighth district, the Republican candidate, anti-immigrant Randy Graf, is so extreme that the Democrats' Gabrielle Giffords looks an easy victor for the House.

The electoral implication is that Arizona's voters as a whole have a more nuanced view of illegal immigration than primary-voting activists. As one well-coiffed (and Kyl-voting) matron in a shopping centre in affluent Scottsdale put it, “If they're here and they work hard and keep their nose clean, there should be a path of citizenship.” That sounds suspiciously like support for the immigration reform envisaged by the president and by Mr McCain, and subsequently approved by the Senate (but not by Mr Kyl) in May.

So will the House's hardline stance turn out to be a mistake? In December it overwhelmingly passed a bill rejecting “amnesty”, and it subsequently rebuffed Mr Bush by refusing to compromise with the Senate, preferring instead to hold immigration “hearings” around the country. The self-serving calculation by the House's Republican majority was that in mid-term elections, with their traditionally low turnout, what matters is to mobilise the base—and that the base is fed up with an influx of poor, Spanish-speaking foreigners changing neighbourhoods and straining public services at the local taxpayers' expense.

The House view may be simplistic. Most analysts regard illegal immigration as economically positive overall. In the forthcoming issue of *Foreign Affairs*, Tamar Jacoby of the right-leaning Manhattan Institute even disputes the notion that immigration depresses wages, arguing that because immigrants “complement rather than compete with most native-born workers”, they raise rather than lower most wages. Whether she is right or wrong—conventional wisdom reckons illegal immigration depresses wages for unskilled Americans by 4% or more—illegals certainly don't seem to raise unemployment: in Arizona the jobless rate in August stood at 3.6%, which was well below the national figure of 4.7%.



But the fears can hardly be dismissed. In New Jersey, for example, the illegal population more than doubled during the 1990s to some 221,000, and has since grown to perhaps 425,000. In Georgia, the

increase in the 1990s was some 571%, to 228,000, according to census figures (but could exceed 400,000 today). Atlanta is one of the so-called “new gateways” for immigration—sprawling cities, with abundant low-end jobs that are a magnet for immigrants. Much of America's south-east (see map) has recently seen immigration levels surprising to anyone who thinks only in terms of the Mexican border.

One result is a swathe of local measures aimed at illegal immigrants. A law in Georgia, for example, imposes a 5% fee on non-citizens transferring money abroad; in Virginia, state workers are now required to verify the legal status of anyone applying for social benefits. In Arizona, voters in 2004 approved Proposition 200, which requires proof of citizenship before receiving state-provided public benefits or casting a vote (this last provision is being challenged in court).

Such measures suggest it is dangerous to appear “soft” on immigration—which is why Democratic candidates across the country constantly underline a commitment to “secure borders”. They also explain why Congress rushed to approve $1.2 billion-worth of fence-building, part of the $34.8 billion homeland-security bill signed by President Bush this month in, appropriately, Scottsdale. It hardly matters that the bill is so full of loopholes that the fence is unlikely ever to be built as advertised. What counts is to be seen making a gesture in time for November 7th.

That leaves one question for the Republicans: how much will their tough gestures on immigration make up for financial and sexual scandals in Congress, and for the war in Iraq? But it also leaves one for Mr Bush: will a new Congress, free from immediate electoral pressure, at last deliver comprehensive reform of immigration policy? Ironically for the president, who first called for such a reform in January, 2004, he may need a Democrat-controlled House to make his dream come true.

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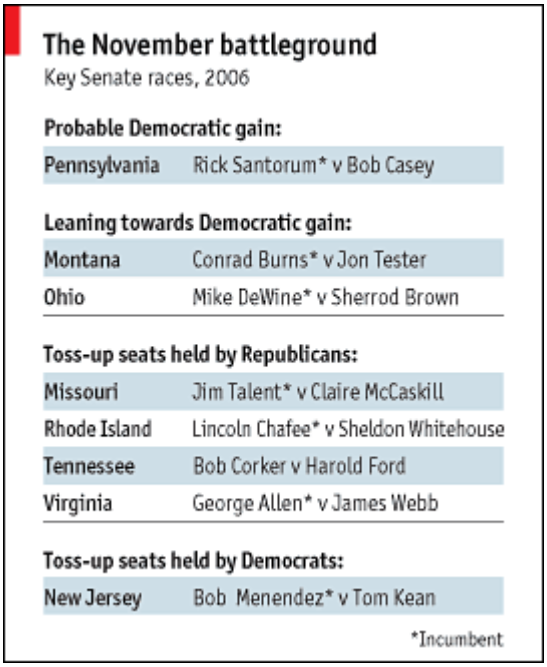
About sponsorship

The battle for the Senate

Cacophony on the centre ground

Oct 19th 2006 | SPRINGFIELD, MISSOURI
From The Economist print edition

Victory depends on who is better at rousing partisans in moderate states


The November battleground
Key Senate races, 2006
Probable Democratic gain:
Pennsylvania Rick Santorum* v Bob Casey
Leaning towards Democratic gain:
Montana Conrad Burns* v Jon Tester
Ohio Mike DeWine* v Sherrod Brown
Toss-up seats held by Republicans:
Missouri Jim Talent* v Claire McCaskill
Rhode Island Lincoln Chafee* v Sheldon Whitehouse
Tennessee Bob Corker v Harold Ford
Virginia George Allen* v James Webb
Toss-up seats held by Democrats:
New Jersey Bob Menendez* v Tom Kean
*Incumbent

“DEMOCRATIC voters are spitting nails and can't wait to vote, while their Republican counterparts are showing signs of despondency,” observes Charlie Cook, a political analyst. Unless something big happens fast, he reckons, the Democrats could capture not only the House of Representatives—their primary target—but also, maybe, the Senate. They need a swing of six seats, out of 33 contested this year, for a 51-49 majority there.

One should be pretty easy. The voters of Pennsylvania appear to find Rick Santorum's harsh blend of piety and politics unpalatable, and he is running well behind. A couple more look likely Democrat wins: the Republicans in Montana and Ohio have ethical problems. But to complete the takeover, the Democrats must hold New Jersey (see article), and win three of four marginal races: Rhode Island, Missouri, Tennessee and Virginia.

These states are now the centre ground of American senatorial politics. But to capture them, both parties are appealing to their most partisan fans. Consider the race in Missouri. The “show-me” state is one of America's bellwethers, having voted for the victor in every presidential election since 1960. Its incumbent Republican senator, Jim Talent, is a soft-spoken moderate who works well with Democrats. His Democratic opponent, Claire McCaskill, is also a moderate, with a solid record as the state auditor. Their differences are hardly gaping, but they are exaggerating them to fire up their natural supporters.

At a televised “debate” in Springfield on October 16th, the two candidates did not debate each other so much as recite sound bites for entirely different audiences. Mr Talent attacked his opponent as weak on terrorism and possibly a tax-dodger. Ms McCaskill peddled the notion that Big Oil has conspired to reduce petrol prices just before the election to keep its Republican buddies in power. Their target audiences seem to like this sort of thing.

Ms McCaskill's fans, for example, gathered at the local Teamsters hall where, crammed with crisps, cupcakes and Coke, they watched the debate on a big screen. When Mr Talent refused to say whether he would vote to raise the minimum wage, he was greeted with howls of derision. “I can barely live on the salary I make,” said Ronald Burke, who works in a nearby factory producing whirlpool baths for people richer than himself, “so I don't see how someone can live on $5.15 an hour.”

On screen, Mr Talent tried to explain why he opposes human cloning. “I don't want to live in a world where I'm walking down the street in one direction and I see myself coming in the other,” he said. A voice called out: “Me neither!” Everyone laughed at how ghastly it would be to have multiple Jim Talents infesting the planet.

In the flesh, Mr Talent is amiable but an awkward speaker: on the stump after the debate he had to remind his audience to clap. But he can draw on a reservoir of support from rural and Christian voters, who typically deplore the Democrats' tolerance of abortion and gay marriage. “If we had a real Christian party, I'd go with that,” says Larry Atkins, a minister attending a Talent speech in Waynesville, a small town north-east of Springfield. But failing that, Mr Talent “is a good moral person.”

The race is a toss-up, according to the polls. The result depends on who gets out the vote, says Mr Talent. Ms McCaskill agrees. The Republicans think they are the best at this, she tells her supporters, “But this time we've got the passion on our side.” Unsurprisingly, given Missouri's importance to the balance of power, the national Democratic and Republican parties are pitching in with oodles of cash and attack ads.

Both sides profess confidence. Ms McCaskill claims to be winning converts in conservative rural areas. One couple, she says, told her they used to vote Republican but were planning to switch because they no longer felt middle class, having lost their health insurance. “Jim Talent will win,” says Missouri's Republican governor, Matt Blunt, stumping for him with bone-crushing handshakes on the county courthouse steps in Rolla, south-east Missouri. Behind him, an eight-year-old girl, urged on by her mother, is giving Mr Talent a hand-written extract from the Bible.

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The New Jersey Senate race

Ethics, schmethics

Oct 19th 2006 | PARAMUS
From The Economist print edition

A contest Democrats should watch closely

AP

Can Menendez stay on the stage?

WHEN Bob Menendez, the Democratic incumbent, started out in this race, he thought he was in for an easy ride. He was the third-highest-ranking Democrat in the House of Representatives until he was appointed to the Senate earlier this year. New Jersey is a blue state—most of the state legislature, the governor and its two senators are Democrats. Yet he is running neck-and-neck with Tom Kean junior, his inexperienced Republican rival.

Mr Kean has made ethics the focus of his campaign. At every opportunity he accuses Mr Menendez of dodgy dealings and of having even dodgier friends. His ads say Mr Menendez's top adviser used his name to help a friend win a juicy contract. Mr Menendez has not been linked to any wrongdoing, but this has not stopped Mr Kean.

Corrupt politicians are nothing new in New Jersey. Nearly 200 public officials have been indicted in the past five years. Robert Torricelli abandoned his 2002 Senate re-election campaign because of allegations of financial impropriety. Two years ago James McGreevey, then governor, resigned amid rumours that he was about to be sued for sexual harassment. No wonder New Jerseyans are fed up with the state's Democrats.

Many are turning to fresh-faced Mr Kean. His biggest advantage is that he is the son of Tom Kean senior, a former governor and the state's most popular politician. Voters may well think his son could be worth a look. Some even think it is his father who is running.

Both candidates have mostly neglected the big issues. New Jersey has the nation's highest property-tax, and tax reform is a much-debated matter. Although senators have nothing to do with setting local property-tax, whoever wins could help shape national tax policy: George Bush's tax cuts may be reversed in 2010, depending on which party controls the Senate.

Certainly the state is too crucial for party leaders to neglect. The big guns have come out to campaign: Bill and Hillary Clinton for Mr Menendez, John McCain, the front-running Republican presidential contender, for Mr Kean.

Mr Bush has not come. He is not a popular fellow in New Jersey, and Mr Menendez has bounced back slightly by linking his opponent to him. He also questions Mr Kean's own ethics, not very subtly, in an ad depicting his rival's face alongside a mugshot of a felon.

The bickering candidates may have gone too far. Ingrid Reed, of the Eagleton Institute of Politics at Rutgers University, said they have done little to engage voters, especially swing voters. Over half of New Jersey voters call themselves independents. If anything, the nasty campaign may force many to say “Fuhgeddaboudit” and not bother to vote.

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Libertarians

The neglected swing voters

Oct 19th 2006 | WASHINGTON, DC
From The Economist print edition

What's a true freedom-lover to do on polling day?

AMERICA may be the land of the free, but Americans who favour both economic and social freedom have no political home. The Republican Party espouses economic freedom—ie, low taxes and minimal regulation—but is less keen on sexual liberation. The Democratic Party champions the right of homosexuals to do their thing without government interference, but not businesspeople. Libertarian voters have an unhappy choice. Assuming they opt for one of the two main parties, they can vote to kick the state out of the bedroom, or the boardroom, but not both.

In a new study from the Cato Institute, a libertarian think-tank, David Boaz and David Kirby argue that libertarians form perhaps the largest block of swing voters. Counting them is hard, since few Americans are familiar with the term “libertarian”. Mr Boaz and Mr Kirby count those who agree that “government is trying to do too many things that should be left to individuals and businesses”, that government, rather than promoting traditional values, “should not favour any particular set of values”, and that “the federal government has too much power”. Using data from Gallup polls, they found that, in 2005, 13% of the voting-age population shared all three views, up from 9% in 2002.

That is easily enough libertarians to tip an election. And their votes are up for grabs. In 2000 George Bush won 72% of the libertarian vote, to Al Gore's 20%, by repeating the mantra “My opponent trusts government. I trust you.” But in 2004, after Mr Bush increased the size of government and curtailed some civil liberties as part of the war on terror, his margin dropped to 59%-38%. The swing was as sharp in congressional races, too. Going back further, libertarians backed George Bush senior by 74%-26% in 1988. But when he sought re-election in 1992, they split evenly between him, Bill Clinton and Ross Perot. A group that can give the eccentric Mr Perot a third of its support must be really disgruntled.

When Republicans win elections, it is because they manage to pull together an alliance between social conservatives and libertarians. But, as Ryan Sager put it in “The Elephant in the Room: Evangelicals, Libertarians and the Battle to Control the Republican Party”: “[L]ibertarians have always tended to see social conservatives as rubes ready to thump nonbelievers on the head with the Bible first chance they get, and social conservatives have always tended to see libertarians as dope-smoking devil-worshippers.”

Mr Boaz and Mr Kirby argue that wooing the libertarian vote could propel either party to electoral success. Yet with an election only weeks away, neither shows much sign of trying. Republicans are rallying their religious base with jeremiads about stem-cell research and gay marriage. Democrats, on the other hand, would put up taxes, block school choice and lead a witch-hunt against Wal-Mart.

Libertarians are ignored partly because they are hard to find, not least because they just want to be left alone. (There is a Libertarian Party, but it gets hardly any votes.) Politicians can reach social conservatives through churches or union members through their unions, but where do libertarians gather? Parties will always court the votes that are cheapest to court because, for once, they are spending their own money.

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Gays and religion

Have you heard the Bad News?

Oct 19th 2006 | BOSTON
From The Economist print edition

Liberty Sunday in liberal-land

SOME conservative Christians see a threat to religious liberty in America in the shape of a children's book. “King & King” is about two princes who fall in love and get married. This spring, a Massachusetts schoolteacher read the book to her seven-year-old students. Rob and Robin Wirthlin, parents who think homosexuality is deviant behaviour, complained. “I'm part of diversity,” said Mrs Wirthlin. “I should be included in your safe and welcoming community too.”

The Wirthlins relayed their tale of woe on “Liberty Sunday”, held on October 15th in Boston. The event was co-ordinated by the Family Research Council (FRC) and broadcast to millions of Christians. It aimed to show how the gay-rights movement is undermining religious freedom.

This is a new line from the Christian right. Unfortunately, examples are rather hard to come by, though another father did complain that his son had once brought home a “diversity bookbag” from kindergarten. So “King & King” was frequently mentioned. Mitt Romney, Massachusetts's governor, railed against it. James Dobson of Focus on the Family sent his condemnation via video. Tony Perkins, the president of the FRC, brought a copy so everyone could understand what they are up against. “The kids were treated to pictures of two princes kissing one another,” he explained, displaying the picture. “Yuck!” shouted someone in the peanut gallery.

“If God calls homosexuality an abomination, if he calls it ‘vile affections’, if he calls it wickedness, [why can't] I call it inappropriate behaviour?” asked Wellington Boone, bishop of the Father's House Church in Atlanta. Despite his complaint, Mr Boone seemed scarcely cowed by political correctness. He anticipated a new Sodom and Gomorrah, and invited closeted homosexuals to come out “and let God deal with you and let the nation deal with you.”

The FRC, however, has much to do before it can argue that antipathy to homosexuality is a key part of Christian doctrine. Among white mainstream Protestants, less than a quarter believe that people can choose to be gay—and nearly two-thirds support civil unions.

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Presidential contenders

The vanishing Virginians

Oct 19th 2006 | RICHMOND
From The Economist print edition

A bad week for the home state of Washington, Jefferson and Wilson

AP

Warner gets a life

"CHALK up two more false pregnancies for the 'Mother of Presidents'," wrote one commentator in Virginia last week. Mark Warner, a former governor, had suddenly withdrawn from the Democratic field of presidential contenders, and many a gaffe seemed set to scuttle the ambitions of a Republican contender, George Allen, the state's junior senator.

Virginia has produced eight American presidents, including four of the first five. Others have been mentioned for the White House: one (Douglas Wilder) briefly tilted a decade ago. But it took Messrs Warner and Allen to re-establish the state's reputation for national political leadership, if only briefly.

On October 12th Mr Warner, a 51-year-old telecoms multimillionaire, drove to Richmond, Virginia's capital, to announce that he would not be running two years hence. He wanted to spend more time with his family and "have a real life", though after spending the better part of the past year raising $9m and travelling to 28 states, he seemed the last person to put the personal ahead of the political.

Mr Warner, who served as an extremely popular and successful governor of Virginia until January, insisted there was nothing scandalous involved. Still, his announcement aroused suspicion. Some suggested the salacious. Others wondered if the decision had to do with his vast business interests. But whatever the reason, his retreat has created a vacuum. He had positioned himself as the centrist alternative to Hillary Clinton, the early front-runner for the Democratic nomination and the darling of the party's liberal activists. Southerners, Westerners and moderates are now shopping for a new candidate, perhaps Governor Bill Richardson of New Mexico or Governor Tom Vilsack of Iowa, Senator Evan Bayh of Indiana or former Senator John Edwards of North Carolina, the vice-presidential nominee in 2004.

Mr Allen may also have been afflicted by the curse of early popularity. The 54-year-old former governor, who is seeking a second term in the Senate while angling for the Republican presidential nomination has now found the former imperilled and the latter probably doomed.

Since mid-August, Mr Allen has been stained by allegations of racial and ethnic insensitivity. It started when he was caught on video hurling an apparent racial slur at a volunteer for his Democratic opponent, James Webb. (Mr Allen claimed he did not know what the word meant.) He then came under fire for apparently suppressing his partly Jewish roots, and for reports that as a college student and young political activist he often used the word "nigger". And now his personal finances are under scrutiny.

All this has made Mr Allen, once an early favourite of conservative activists, seem shop-worn. He is neck-and-neck with Mr Webb, spending more and more of the money he had apparently hoped to save for a national campaign. That, though, looks increasingly unlikely.

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Housing in New York

A big deal

Oct 19th 2006 | NEW YORK
From The Economist print edition

A record-breaking and politically hot property sale in Manhattan

Corbis

Going, going, gone

SOME of New York's shrewdest investors are evidently unimpressed by the notion that America's housing market is in trouble. This week, in a record-breaking deal, a bunch of them splashed out $5.4 billion to buy an 80-acre (32-hectare) residential estate on the lower East Side known as Stuyvesant Town and Peter Cooper Village. That was almost 10% more than the asking price set by the current owner, MetLife, an insurance company. It had been expected to go for closer to $4 billion, not least because of fierce political opposition to the sale of what has long been—for good reasons and bad—the emblem of affordable housing in the city.

Stuyvesant Town and the slightly higher-end Peter Cooper Village were built in 1947, with the help of tax breaks, to provide homes for soldiers returning from the war and public-sector workers. (At first, at odds with the estates' current image as a model community, only whites were allowed, a policy that was abandoned, after some nasty scenes, in the 1950s.) The high-rise estates include 110 unremarkable brick buildings with 11,232 apartments, home to about 25,000 tenants.

Around two-thirds of the apartments enjoy below-market rents protected by New York's notorious rent-control laws, and many tenants fear that a new, more commercially minded owner who has paid top dollar for the properties will make their lives less comfortable.

Among other things, tenants suspect that some of the ample open space on the estate might strike the new owner as development material. Jerry Speyer, who is buying the estates with BlackRock, an investment bank, is one of New York's leading commercial landlords, and owns a portfolio of famous properties including the Rockefeller Centre and the Chrysler Building, but this represents his first big move into residential property. Hoping to reassure tenant representatives, Mr Speyer says that thousands of tenants in rent-stabilised apartments are “completely protected by the existing system” and that he has no plans to develop the open space. This convinces no one living there.

Strikingly, city and state officials have failed to come up with the sorts of tax breaks and other help that would have been necessary for a tenant bid to succeed. It seems they concluded that New York's taxpayers have better uses for their money than adding to what many regard as a large subsidy to property markets in other places, such as Florida. Allegedly, many residents of Stuyvesant Town and Peter Cooper Village use the money they save by paying below-market rent to buy second homes. Even

so, the tenants are determined to fight on. Given the weak spines of many New York politicians, they may not do so in vain.

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Lexington

Deconstructing the God squad

Oct 19th 2006
From The Economist print edition

Not all conservative Christians are Republicans

IT HAPPENS every election cycle. The Washington crowd rediscovers a strange tribe called “conservative Christians”. It doesn't often meet them, of course: there are very few Bible-thumpers at the bar at the Palm. But every other year the press pack remembers that, for some odd reason, such people have been given the vote—and sets about endowing them with awesome political power.

The press—Lexington included—swallowed Karl Rove's argument that the Republicans were robbed of a conclusive victory in 2000 because 4m evangelicals were not urged to the polls. In 2004, many journalists argued that George Bush's win was clinched by “values voters” who turned up to the polls in huge numbers to express their opposition to gay marriage.

This year the buzz is that the values voters could sit it out once again as a result of scandal and betrayal. The scandal is, of course, the Foley affair, involving a congressman, smutty e-mails and young men. The betrayal is revealed in a new book, “Tempting Faith: An Inside Story of Political Seduction” by David Kuo, a former White House staffer. Mr Kuo argues that the Bush administration was never serious about “compassionate conservatism”. White House operatives treated faith-based social services as a way of winning votes; some of them even referred to Christian activists in private as “nuts”, or “goofy”.

Mr Kuo's book will no doubt add to Republican despondency. But it would be a pity if the book reinforced exaggerated claims about values voters. Post mortems on the 2004 election revealed the idea that “values” were the most important issue in the election was based on a misreading of the polls. Iraq and terrorism were listed separately. But the two together were the chief worry for 34% of the electorate, compared with just 22% who plumped for values. This misreading rested on a bigger misunderstanding of the role that conservative Christians—ie, Christians who identify with conservative denominations—play in American politics.

These mysterious people actually make up a third of the population. Common sense would suggest that they do not think alike. Now two academics have found data to support common sense. In a new study, “The Truth about Conservative Christians”, Andrew Greeley and Michael Hout, two sociologists, explode some cherished myths.

The first myth is that conservative Christians put “values” above material interest. From the left, Thomas

Frank (in his book “What's the Matter with Kansas?”) argued that the reason why the Republicans have done so well in that state—and by extension across the board in meat-and-potatoes America—is that they have used values to dupe ordinary Americans into voting against their interests. From the right, Gary Bauer, a failed Republican presidential candidate who now heads a group called American Values, praises voters “who place ideals over immediate physical needs”. In fact, though, class matters: poorer Protestants are much less likely to vote Republican than affluent ones. And conservative Protestants are actually more likely to support progressive taxation than “mainline” Protestants are.

The second myth is that they have cast-iron views on morality. In fact, only 14% of them oppose abortion in all circumstances, even when the mother's life is in jeopardy—whilst 22% of them are consistently pro-choice. On many moral issues conservative Christians are moving, slowly, in the same direction as the rest of the population. Large majorities support sex education in schools. Up to half of them have lived together before getting married. Opposition to homosexual sex is declining.

The biggest myth of all is that conservative Christians are dyed-in-the-wool Republicans. Mr Bush certainly enjoyed a big lead (17%) among weekly churchgoers in the last election. But he enjoyed a bigger lead (19%) among married people with children; in a closely divided country you can slice the electorate into all sorts of groups that “delivered” the election.

Churchgoers up for grabs

Bill Clinton did significantly better among conservative Christians with below average incomes than either George Bush senior or Bob Dole. This year the Democrats could repeat his success. A Gallup poll conducted on October 6th-8th shows that among “white frequent churchgoers” the margin of support for Republicans over Democrats has shrunk from 22% in September to nothing today. Ken Blackwell, a leading social conservative who is running for the governorship of Ohio, is more than 20 points behind his opponent.

Mr Kuo is not alone in producing evidence that some in the White House regard the religious right as goofy. In his latest tome, “State of Denial”, Bob Woodward quotes Mr Bush describing Mr Blackwell as a “nut”. This certainly suggests cynicism, but also shows that the White House treats Christian activists like any other pressure group—to be stroked, but not bowed down to. Mr Bush has done little about abortion because he knows it appeals only to a fringe.

One should not follow Messrs Greeley and Hout too far. Christian activists are an important part of the Republican coalition—influential in vetting candidates for primaries, getting out the vote and putting pressure on Congress. But these elites do not speak for an undifferentiated mass of Christian Americans. Conservative Christians may put a bit more emphasis on values in making political choices—but they also consider more mundane things. The good news for Republicans is that this will limit the fallout from Mark Foley's behaviour or Mr Kuo's revelations. The bad news is that it means that Christian conservatives will do what other Americans are doing: judge the ruling party's performance on earthly things like Iraq and good management, and find it wanting.

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The Panama Canal

The voters and the ships

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From The Economist print edition

AFP

Easing a bottleneck of world trade depends on persuading Panamanians that the arithmetic of an ambitious canal expansion adds up

ALMOST half of the ships that pass through the Panama Canal fit its locks perfectly. And yet, with a scant half metre on either side, and not much more space fore and aft, the perfect fit serves only to make these “Panamax” ships look out of place. They are penned in: lifted and lowered by enormous surges of water in and out of the locks, while tied to locomotives to prevent them touching the sides. They seem far too big to be surrounded by land.

That so many of the ships that transit the canal have been specifically designed to make the most of it is testimony to its importance to world trade. Some 5% of the world's seagoing traffic passed through it in 2005, including over a third (by weight) of cargo going from north-east Asia to the United States' east coast.

Rapid growth in world trade means that the canal is suffering congestion. A modernisation programme costing $500m is under way, involving new locomotives, lights and safety systems. But the Panama Canal Authority, a semi-autonomous government agency which has run the canal since the United States handed it over to Panama in 2000, says that the waterway will be running at its full capacity by 2009.

The authority has drawn up an ambitious plan to double capacity and to accommodate “post-Panamax” ships, which are increasingly common. It says the expansion will cost $5.2 billion. The plan includes building a third pair of locks—one at each end of the canal—to take ships that are more than twice as big. In addition, the navigational channel would be deepened and widened. The authority hopes to finance the plan by raising its tolls.

Under Panama's constitution the voters must decide in a referendum, to be held on October 22nd, whether the expansion should go ahead. Polls suggest the proposal will be approved by a margin of at least 10%. But the politics of expansion are far from straightforward.

Panama's president, Martín Torrijos, whose father negotiated the handover of the canal to Panama, has campaigned hard for the plan. The referendum is in part a vote of confidence in Mr Torrijos's government, admits Samuel Lewis Navarro, the foreign minister. The vote has been repeatedly delayed, in part because the government was unpopular after it pushed through a much-needed pension reform.

Opponents of the plan, who are less well-funded than its supporters, make three points. They say it is unnecessary, that it will cost more than $5.2 billion and that it might have a negative impact on the environment. Mr Lewis dismisses all three points. He says that the budget for the expansion includes a 30% allowance for unforeseen cost overruns, and that the plan has been well-studied, both to ensure that sufficient demand exists and to minimise the environmental impact.

Francisco Míguez, an engineer who is co-ordinating the expansion plan for the authority, stresses that it is not a “greenfield” project. The geology is well-understood, and some of the excavation for the new locks was done in an aborted American effort in the 1940s. Because the new locks will have recycling chambers, they will use 7% less water than the existing locks, despite their larger size. Although some environmentalists say the proposed expansion might cause salt levels to rise in Lake Gatun, through which the canal passes, mainstream environmental groups have all endorsed the proposal.

It seems clear that trade will increase on the routes the canal serves. But as ever, there are plenty of blueprints for rival crossings of the Central American isthmus whose promoters would love to see Panamanians reject expansion. A hoary plan to build a canal in Nicaragua was dusted off last month, surely not by coincidence. Enrique Bolaños, Nicaragua's president, who backs the scheme, says it would cost $18 billion and take 12 years to build.

“If we have the capacity, they have no chance,” says Mr Míguez of the Nicaraguan scheme. He adds that plans for transisthmian railways in Mexico and Central America are not real competitors because moving a container from the Pacific to the Caribbean would cost ten times more than through the expanded canal.

But for Panama much is riding on whether the authority has got its sums right. If demand rises as forecast, the expansion can be delivered to budget, and if shippers do not balk at higher tolls, the canal will be even better business for the government. Payments from the canal currently account for 17% of government revenues, according to Guillermo Chapman, an economist in Panama City.

Large infrastructure projects almost invariably go over budget. The attempt to build a canal in Panama bankrupted Ferdinand de Lesseps and many French investors, as well as costing the lives of thousands of construction workers. But once Theodore Roosevelt had “won the isthmus” by creating Panama as an American neo-colony, the final construction of the canal cost less than budgeted, as Mr Míguez likes to point out.

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Ecuador

Banana republic

Oct 19th 2006 | QUITO
From The Economist print edition

A choice of contrasting populisms

EPA

No, that's not a list of Noboa's companies

Get article background

"JUST one round," sang the supporters of Rafael Correa, who had led the opinion polls heading into the first round of Ecuador's general election on October 15th. Now they are grateful there will be another. With more than 90% of the votes counted, Mr Correa, an America-bashing friend of Venezuela's Hugo Chávez, had just 23%, behind Álvaro Noboa, a pro-American banana tycoon, with 26.2%. So voters face an unattractive choice of contrasting populisms in a run-off on November 26th.

Mr Correa, who calls himself a "Christian leftist", threatens to default on Ecuador's foreign debt and to re-negotiate contracts with foreign oil firms. He rejects the idea of a free-trade agreement with the United States (awkwardly for Ecuador, neighbouring Colombia and Peru have each signed one). Mr Noboa is more ostentatiously religious (he has described himself as a "messenger of God"). He is pro-free trade and pro-private business—he owns more than 100 businesses himself. He says his government would shun Mr Chávez and Cuba's Fidel Castro. Ecuadoreans will doubtless vote on local concerns. But they will also be deciding which side to back in the tussle for regional influence between the United States and Venezuela.

Neither candidate offers much hope to a chronically unstable, oil-rich country that has toppled three elected presidents in the past decade. Mr Correa represents a popular yearning, sharpest among the middle class, to smash a cabal that controls both the economy and politics. He would do so by convening a constituent assembly to rewrite the constitution, bypassing a Congress he considers to be irredeemably corrupt. He fielded no congressional candidates. Mr Correa's proposal echoes the methods that Mr Chávez used to eliminate restraints on presidential power.

Mr Noboa offers continuity, but of a worrying kind. He denies claims by Human Rights Watch, an NGO, that banana plantations that supply his company employed child labour. But he invites comparison with Italy's Silvio Berlusconi, in that it would be hard to disentangle his business interests from his political actions. His running mate is his lawyer; his leading congressional candidate in his home province is his wife. His party lacks people capable of managing the government, says Walter Spurrier, a political analyst in Guayaquil. Mr Correa, who has a PhD in economics from the University of Illinois, has readier access to expertise.

Mr Noboa, who has run twice for the presidency before, combines free-market rhetoric with populist gesture. Promising "bread, housing and jobs", he tours poor neighbourhoods distributing credit to entrepreneurs and on-the-spot medical care. Mr Correa offers less tangible benefits. Debt service should never exceed investment in social programmes and defence, he says. To spur domestic credit, banks should be obliged to repatriate funds they hold abroad.

"Noboa and Correa represent different types of populism," says Polibio Córdova of Cedatos, a polling company. Mr Correa offers "educated populism", while Mr Noboa purveys the "mass-market" variety.

Mr Correa claimed, with scant evidence, that the vote had been rigged against him. An observation team from the Organisation of American States detected no fraud. Mr Noboa probably has the edge for the

second round. He is more likely to inherit votes from some of the traditional political parties, and those of Gilmar Gutiérrez, the brother of the deposed president, Lucio Gutiérrez, who surprisingly came third. Mr Correa must now decide whether to reassure voters by toning down his radical rhetoric. Ecuadoreans want change, but it seems they do not want strife.

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Venezuela and the UN

The empire fights back

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A defeat looms for Hugo Chávez

Get article background

IT WAS billed by Venezuela's foreign ministry as perhaps “the most important action in the history of [the country's] foreign policy”. There could be no doubt, officials from Hugo Chávez down had confidently proclaimed, that the United Nations General Assembly would choose Venezuela rather than Guatemala to fill one of Latin America's two rotating seats on the 15-member Security Council. Mr Chávez planned to use the seat to denounce the doings of the United States, which has backed Guatemala.

After 22 rounds of voting in two days this week, Mr Chávez's confidence was shown to be misplaced. In the first vote, Guatemala won 109 votes to 76. Most of the subsequent ballots showed a similar result. Neither country seemed likely to obtain the needed two-thirds majority of those voting, and each seemed to have enough votes to block the other.

For Venezuela, that amounted to a big defeat. In pursuit of the seat, Mr Chávez had criss-crossed the globe in recent months, signing deals, promising aid and receiving promises of support. The votes of the Arab League, the Caribbean Community and the African Union were all said to be in the bag, as well as those of Russia, China and five South American countries. A “new era” was about to begin at the Security Council in which the power of the “empire”, as Mr Chávez calls the United States, would finally be challenged by “the conscience of the peoples”.

Guatemala had quietly been lobbying for the post since 2002. It had already beaten Venezuela for a place on the newly formed UN Human Rights Council earlier this year. Rather to the embarrassment of its foreign minister, which insisted that its was an “independent voice”, it had the very public support of the United States.

What went wrong for Venezuela? Its ambassador to the UN predictably blamed American pressure and “bribes”. In reality, it probably never had as many votes as it claimed. Moderate Arab states were concerned at Mr Chávez's friendship with Iran; some in Asia dislike his equivocal attitude to North Korea's nuclear ambitions. Some Caribbean countries may also have deserted. Mr Chávez's speech to the General Assembly in September, in which he referred to George Bush as “the devil”, almost certainly cost it further support.

Chile, whose ruling coalition suffered a bitter split over Venezuela's candidacy, and which abstained, talked of a compromise candidate. Names mentioned have included Uruguay, the Dominican Republic and Costa Rica. But compromise may not come quickly: in 1979-80 a similar battle between Colombia and Cuba lasted for three months and 155 rounds. Mr Chávez said Venezuela would “not negotiate with anyone” and that the United States would have to “defeat us there on the battlefield.”

This has been a bad week for Mr Chávez. A friend, Rafael Correa, trailed in Ecuador's election (see article). That confirmed a trend in Latin American elections this year in which candidates seen as allies of Mr Chávez have lost. He will hope that trend will be bucked by Daniel Ortega, the Sandinista leader, in Nicaragua's election next month.

Mr Chávez himself faces a presidential vote on December 3rd. He leads the opinion polls. But many Venezuelans would prefer their president to spend less time and money overseas and more on crime, unemployment and corruption at home. “The country's in bad shape because he [Chávez] is worried about problems abroad,” said Jessica, a young mother in 19 de Abril, a working-class neighbourhood in Caracas. “He should pay attention first to the problems of our country.”

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Canada

From books to soundbites

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An intellectual struggles to adapt to a political campaign

CANADIANS have seen it before: an outsider to politics with glittering academic credentials throws his hat in the ring for the Liberal Party leadership and is the surprise winner. It happened for Pierre Trudeau in 1968. Can it now happen for Michael Ignatieff?

Reuters

On third thoughts, today my real policy on the Middle East is...

Mr Ignatieff made his name as an academic and writer in Britain before becoming the director of Harvard University's centre for human-rights policy. Since offering himself as a candidate in the leadership race, to be decided at a convention in December, he has been much compared to Trudeau, prime minister for all but nine months between 1968 and 1984.

Both were controversial as intellectuals. Both were articulate, attractive to women, and caused a stir that went well beyond Liberal Party ranks. Mr Ignatieff may even have taken lessons from Trudeau, for whom he once worked as a campaign organiser.

But the differences are more telling. For all his youthful globetrotting, Trudeau spent his adult life working in Canada, and served as a member of parliament and a cabinet minister. He may have been little known outside the universities of Quebec when he went for the top job, but he was not inexperienced.

Mr Ignatieff lived outside Canada almost continuously from 1978 to 2005, when he returned to stand for parliament in last January's general election. His political apprenticeship is being served in the unforgiving glare of the media spotlight.

His long absence from Canada lays Mr Ignatieff open to the charge of being out of touch with public sentiment. Most Canadians opposed the war in Iraq, which he initially supported. “Ignatieff's stand on Iraq is his Achilles heel,” says Peter Donolo, a pollster who worked for Jean Chrétien, a former Liberal prime minister. It aligns him too closely with Stephen Harper, the Conservative prime minister, as well as with George Bush. Mr Ignatieff's proposal to give Quebec special status boosted his fortunes there but fell flat with Canadians elsewhere, who are tired of decades of constitutional wrangling.

Even so, Mr Ignatieff's campaign has garnered him the support of almost 30% of the delegates to the leadership convention. Bob Rae, who was premier of Ontario when a member of the social-democratic

New Democrats, has 20%. Gerard Kennedy, a former minister in that province, and Stéphane Dion, a former environment minister (with a dog named Kyoto), are close behind. The delegates' votes are committed only for the first ballot, so any of the top four could emerge as the winner.

Much will depend on whether Mr Ignatieff cures his current bout of foot-in-mouth disease. He is used to nuanced argument. That does not work well in politics. Earlier this summer he said that he was not losing sleep over Lebanese civilians killed by Israeli bombs. That caused an uproar. This month, he seemed to change his mind, saying the bombing appeared to be a war crime. Both comments were snippets of a longer discussion. Reduced to soundbites, the first sounded callous and the second like a flip-flop.

John Manley, a former Liberal cabinet minister and once a leadership contender, says Mr Ignatieff made two mistakes in his comments. He talked about foreign policy, in which votes can only be lost, not won; and he managed to antagonise both sides in the conflict by reversing himself. In academia, it is appropriate to see every side, says Mr Manley. In politics you have to take a stand. Trudeau knew that instinctively. Mr Ignatieff still has to learn.

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China

Dreaming of harmony

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ROPI

Though the government talks of making a more equitable society, China's peasants are still miserable

IT IS the end of a good harvest for crab apples in Dagucheng village, but the locals are not celebrating. Even after the central government's decision to scrap an ancient agricultural tax from this year, residents of the village, in a poor quarter of Hebei province 50 miles (80km) north of Beijing, say they will be no better off. A recent decision by the Communist Party to build a “socialist harmonious society”, in which peasants prosper and corruption fizzles, was met in the village with scepticism.

Rarely since the days of Mao Zedong has the party leadership formally declared such a utopian objective as it did on October 11th, by approving a document on building a harmonious China. For President Hu Jintao, whose speeches have been filled with calls for harmony since he took over as party chief four years ago, the document's adoption by the party's Central Committee was an important rite of passage. The next step, possibly next year at a five-yearly party congress, is likely to be the rewriting of the party's constitution to make harmony one of its goals. Mr Hu will then officially become one of the party's great “thinkers” alongside Mao, Deng Xiaoping and Mr Hu's predecessor, Jiang Zemin.

The full text of the document, published on October 18th, prescribes many ways to make China harmonious. They include promoting political reform (how is not said) and cracking down on domestic and foreign “hostile forces”. Another element, officials say, is creating a “new socialist countryside”, as distinct from the present one where corruption is rampant, health care and education are becoming prohibitively expensive and incomes are falling ever further behind those in the booming cities. Dagucheng's only non-agricultural venture, a canning factory, collapsed a few years ago. Average annual cash income per peasant is about the same now—around 2,000 yuan ($250)—as it was at the beginning of the decade, villagers say.

Since the party committed itself to reforming the countryside a year ago, it is difficult to identify much change. In some villages near Dagucheng, roads have been repaved. Abolishing the agricultural tax has saved the average peasant around 100 yuan a year. Next year, fees at Dagucheng's primary school (200 yuan a year) are supposed to be abolished as part of a nationwide campaign to eliminate them in the countryside for the first nine years of education. But like many rural schools, Dagucheng primary is meanwhile cutting costs by relying increasingly on unqualified teachers. Villagers are uncertain when

they might benefit from a new health-insurance scheme that the government says will be available in 80% of rural counties by 2008. For now they have to pay market rates at the village's private clinics. But even when insurance becomes available, they will still have to pay between 35% and 60% of treatment costs themselves.

Li Fan, a consultant in Beijing, says that abolishing agricultural tax has been a blow to local government finances, notwithstanding increased subsidies from Beijing. He says his research in Hengyang, a county of central Hunan Province, earlier this year found that, in order to balance their budgets, governments were cutting various payments to peasants. These included rewards for having only one child and planting trees. Mr Li predicts that any gains peasants have made are likely to be offset by such measures within the next two or three years.

The Central Committee document establishes ambitious goals. The environment is to get “conspicuously better”. The widening gap between urban and rural areas is to be narrowed. Wealth is to be spread more evenly. Pensions are to be made available for everyone, not just those enjoying the privileged status of registered urban residents. In the build-up to the Central Committee meeting, the official media even praised welfare systems in northern Europe. The committee has set a date for achieving harmony in China. It is to happen by 2020.

Mr Hu needs to appear concerned about welfare issues. Party conservatives have become increasingly critical of the inequalities generated by China's rapid growth. There have been growing numbers of popular protests over matters such as corruption and the seizure of agricultural land by local governments. Mr Hu wants to consolidate his power and begin grooming his successors at next year's congress. To do this he will need to go some way towards addressing these grievances.

But China is not about to change course dramatically. Mr Hu can afford to spend more on the countryside, health care and education thanks to strong growth in government revenues. But he and other party leaders remain focused on the party's paramount objective: maintaining social stability. Although corruption, rural poverty and damage to the environment threaten this, party leaders are still more concerned about the danger of unemployment. China's roaring growth—driven by urban investment and exports—has helped contain this problem. In Dagucheng as in many Chinese villages, remittances from villagers who have found work in urban areas have helped to raise living standards considerably. At a meeting this week of China's top advisory body, a senior member said that job creation should be a “priority” in the building of a harmonious society. This year, the urban job market is expected to provide work for only 11m of 25m job seekers.

Mr Hu may take comfort from the recent findings of government statisticians in Beijing. Nearly 47% of residents surveyed said the capital was harmonious already, and nearly 43% said it was “generally” so. The city's “harmony index”, a separate effort to measure feelings in Beijing, has been rising 3.1% a year on average since 2001 (notwithstanding a notice recently erected by the police in your correspondent's neighbourhood warning women not to venture out unaccompanied). The party appears well on target.

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North Korea

Pinched bellies

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Fresh sanctions on North Korea are not supposed to hurt its people, but may do

Reuters

Mind your sanctions

A NUCLEAR capability may be the toast of North Korea's leaders, but it is a blight on their poor countrymen's bellies. Even before fresh sanctions were imposed against the rogue nation this week (see article), in response to its nuclear test on October 9th, North Korea could not feed itself. The latest international strictures are not supposed to inflict further damage on its food supply. But with few trustworthy observers in the country—and the level of aid it gets from China hard to ascertain—damage may be done nonetheless.

To feed itself, North Korea needs 5.5m tonnes of grain a year. It cannot produce anything like this, even with a bumper harvest last year. That crop was sufficient, however, to embolden the regime of Kim Jong Il last December to force the UN's World Food Programme (WFP) to leave the country, because it felt humiliated by its dependence on emergency relief. To fill the hole dug by this moronic policy, the regime had some success improving its food distribution. It was also counting on getting food aid from South Korea, its biggest donor. That changed after the regime tested missiles in July, and South Korea froze its humanitarian aid. After the nuclear test, the South reaffirmed its decision.

For ordinary North Koreans, the loss of aid from the South may be a disaster. In May, as hunger bit in the countryside, workers were ordered from idle factories to go and help on the land. Even the armed forces, which Mr Kim favours above all, have felt the pinch. A general is reported to have ordered soldiers to eat locally-found potatoes, rather than expect grain. This presumably increased pressure on local food supplies. North Koreans have told aid workers that they dread sending their sons to army units that are known to have especially high rates of malnutrition.

As if this were not bad enough, ten days after its offending missile tests, North Korea suffered its worst flooding in recent memory. Relentless rains destroyed crops and, in central North Korea, sent mudslides into villages and towns, as terraces on denuded hills collapsed. The army was in no state to help: it was on a near-war footing in response to the passage of a UN resolution condemning the tests. Good Friends, a Buddhist NGO in South Korea that collects reports from the North, says that 55,000 people, including many soldiers, drowned or went missing in the floods. Others dispute this figure.

To alleviate the crisis, South Korea said it would make flood relief an exception to its suspension of aid. But only half of a promised 100,000 tonnes of grain had arrived before the nuclear test, whereupon South Korea suspended the rest. In the next year, aid workers say, North Korea may fall short of at least 800,000 tonnes of grain. The WFP, which has returned and resumed operations with a staff one-fifth its former size, has the regime's permission to feed 1.9m North Koreans. But it has funds to help only 1m, in 30 of North Korea's 200-odd counties. The WFP says it has brought in just 75,000 tonnes of food this year, and that it will run out of milk powder in November and flour and cooking oil next January. Western powers seem unfussed by this shortage. This week, Condoleezza Rice, America's secretary of state, said America would not contribute to the WFP's operation in North Korea because of a lack of transparency in the country—as if the UN could fix this.

There is meanwhile a hoary assumption that China will not let North Korea collapse by suspending the aid it is often supposed to have supplied: it is said to have sent 500,000 tonnes of grain in 2005. Yet household surveys by the WFP last year found no Chinese grain. Even before the proliferation crisis, the

International Crisis Group, a think-tank, concluded from research in China that its food aid was minuscule. It is probably now smaller still.

By contrast, North Korea's trade with China (including in food) has grown fast. Last year the country imported over $1 billion-worth of Chinese goods. New UN sanctions against it may change that. This week branches of the Bank of China close to the border stopped doing North Korea-related business, either at their government's decree or because of concerns that their loans could soon go bad.

North Koreans are somewhat more protected today than they were before the great famine of the mid-1990s, in which perhaps 1m died. Many can smuggle, trade, bribe, and grow food on individual plots. Still, according to the UN, a third of North Korean women with children under 24 months are malnourished or anaemic, and more than a third of children under six are stunted. One outlet for the hungry in the 1990s was China, to which 50,000-100,000 North Koreans crossed. That route is now closing, at least for those without money. In the past month, authorities in China's north-east have cracked down with dawn raids on neighbourhoods in search of North Koreans. This week, a barbed-wire fence was going up along the border. China is taking no risks.

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Arms sales in India

Scandalous procurement

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Round up the usual suspects

DEFENCE procurement in India has a big element of farce. For two decades, arms companies have been forbidden to use agents in their efforts to peddle wares to the government; a ban they have routinely ignored. The agents are well known. Some are fixtures on Delhi's diplomatic circuit; one owns a central Delhi hotel; another has a publicly declared stake in a low-cost airline. Together with their underlings, who are dubbed middlemen, they are present in virtually every defence deal—though they are not allowed to visit the Ministry of Defence (MOD) or meet officials. Nor do they seem to suffer unduly when, in need of a high-profile scapegoat, governments occasionally raid their offices and homes, and leak damaging allegations about their business activities to newspapers. Of course, these usually turn on the agents' involvement in a defence deal under the previous administration.

This cycle was repeated on October 10th. The Central Bureau of Investigation (CBI), which is controlled by the Congress-led government, raided 35 agents' premises in Delhi and other cities. It then registered cases against George Fernandes, the defence minister in the previous government, led by the Bharatiya Janata Party; Jaya Jaitley, a former president of Mr Fernandes's Samata Party, and Admiral Sushil Kumar, a former navy chief, over a $269m order placed in 2000 with Israel Aircraft Industries (IAI) for its Barak missile system.

The CBI alleged that Ms Jaitley received an illicit payment of 20m rupees (then $433,000) on the deal, and that the admiral “colluded” in the scam by favouring the Barak over a missile system called Trishul, which was being developed by the DRDO, India's leading defence research establishment. This is despite the fact that the Trishul was nowhere near ready for commissioning in 2000, 17 years after the DRDO started work on it, and little progress has since been made. Moreover, India's navy is happy with the Israeli missiles. In January the DRDO and IAI struck a $350m deal to develop jointly a long-range Barak air-defence system for use by their two countries' navies.

The forlorn bid to ban agents was introduced by the late Rajiv Gandhi, a Congress prime minister in the mid-1980s. But instead of sluicing the system as he intended, the ban criminalised agents without banishing them. One resulting scandal, involving agents in a Bofors howitzer gun contract, dragged on for almost the duration of the ban; it was ended earlier this year. There have been several efforts to end the farce by registering reputable representatives of defence companies, as opposed to dodgier freelancers. On October 14th Manmohan Singh, the prime minister, said that since agents could not be eliminated, they should perhaps be recognised. But MOD officials, some of whom have prospered from the current mess, are loth to register anyone. For their part, the agents fear that if they are registered, they will have to pay a good deal more tax.

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Sri Lanka

War again

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The conflict intensifies

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NO ONE talks peace while waging war better than Sri Lanka's government and Tamil rebels. The two sides are due to meet in Geneva on October 28th and 29th, in the latest bid to end their 28-year conflict. They are meanwhile engaged in some of their fiercest fighting in years. More than 1,000 people have been killed since April. Some 220,000 have been displaced, mostly Tamils and Muslims in the north and east of the country, where the rebel Liberation Tigers of Tamil Eelam are fighting for an independent homeland. This week, among other horrors (see map), the Tigers conducted suicide bombings on navy targets, including one on a naval convoy near Habarana that killed nearly 100 sailors, and two on a base beside the southern tourist resort of Galle. In response, government jets intensified a bombing campaign in the east of the country that has cost hundreds of civilian lives.

It is fruitless to ask which side started the latest violence, which erupted in April in a dispute over control of water in the eastern district of Trincomalee. But it has conclusively ended a much-transgressed 2002 ceasefire. At present, neither side looks inclined to stop fighting. Both are rearming, with the government reported to be planning to double defence spending to 139.6 billion Sri Lankan rupees ($1.3 billion) next year. At best, the talks in Geneva may lower the temperature and lead to a more constructive round of dialogue. But there is a good chance that the two parties will merely use them to trade insults before an international audience and justify their military action.

The conflict intensified in July, after the Tigers closed a dam in Trincomalee, thereby denying water to 30,000 farmers, mostly of the Sinhalese majority. In a subsequent ground assault, the government recaptured a number of eastern towns, including Mutur and Sampur. In an apparent bid to chase away nosy foreign aid groups, government troops allegedly executed 17 employees of a French agency, Action Against Hunger. The army easily repulsed the Tigers' counter-attack.

On October 11th the government launched a three-pronged offensive from the northern coastal towns of Muhamalai, Kilaly and Nagarkovil. Its aim was to clear the rebels from the northern Jaffna Peninsula and capture their headquarters at Kilinochchi, near the peninsula's neck. But the government had miscalculated. The peninsula was heavily mined and easily defended by determined rebels. Government

air strikes were limited by a fear of friendly fire. The assault crumbled, with an estimated 130 solders killed and more than 400 injured. Tanks and armoured personnel carriers were also lost in a serious defeat.

Frail hopes that this might coax the government to negotiate with its enemy were swiftly disappointed. Instead, it intensified its bombing in the east. On October 16th President Mahinda Rajapakse told a special envoy from Japan, Yasushi Akashi, that he would escalate the war again if his troops were attacked. Mr Rajapakse's lack of enthusiasm for foreign peacemakers and their suggested compromises is well known. He won power last year after taking a hard line against a more conciliatory candidate, Ranil Wickremesinghe, formerly the country's prime minister.

Mr Rajapakse exploited a Sinhalese fear that the federalism Mr Wickremesinghe championed was a prelude to splitting the country. The rebel leader, Velupillai Prabhakaran, approved of Mr Rajapakse's bellicosity; he had also had enough of foreign peace efforts. Thus he prevented pro-Wickremesinghe Tamils from voting, ensuring Mr Rajapakse's election. Given that the recent fighting is what both government and rebels want, the chances of ending it are thin.

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Nigeria

Capping the well-heads of corruption

Oct 19th 2006 | ABUJA AND PORT HARCOURT
From The Economist print edition

AP

Years of hard-won reform are at risk in the run-up to next year's elections

WITH the local airport closed for an upgrade, oil executives wanting to get to Port Harcourt, the hub of the country's oil-producing Delta region, are expected to negotiate the highway into town from Owerri airport, 85km (53 miles) to the north. The journey offers a telling snapshot of contemporary Nigeria. As of last week, there were 18 police and military checkpoints, mainly on the look-out for bribes, and 14 pot-holes so cavernous that traffic had to abandon the carriageway altogether to get any farther. All this on the region's main commercial artery. There were also 165 advertisements for local churches, of every conceivable denomination, and six mortuaries. It is a heady mix of corruption, pollution and decay, with just a hint of salvation. Unsurprisingly, many oil-men do not bother with the road and take a helicopter instead.

Moreover, the road passes through what, in theory at least, should be one of the wealthiest areas in Africa; from here flows about one-tenth of the world's crude oil. Nigeria is the fifth biggest supplier of America's crude imports. It is also crucial to the future of Africa: the continent's most populous country and its largest economy after South Africa, with which it jostles for continental leadership. In other words, Nigeria matters—which is why there are now growing fears for its stability after several years of apparent progress under President Olusegun Obasanjo.

Most obviously, an insurgency is worsening in the Delta region, with regular attacks on oil installations, kidnappings of Western oil workers and car bombings. Shoot-outs with the army and police are now serious affairs; on October 2nd about ten soldiers were killed in one such clash. A shadowy group calling itself the Movement for the Emancipation of the Niger Delta, which demands that more of the oil revenues go to the local people, is responsible for most of the mayhem. So effective has its campaign been that it has managed to shut down about 20% of the country's oil production.

But as well as the threat to the oil industry, which provides some 80% of the government's revenue, there is increasing nervousness about the state of democracy ahead of presidential and state elections due to be held in April next year. The elections that Mr Obasanjo, a former general, won in 1999 had seemed to end a depressing cycle of decades of military coups and dictatorships. Nigerians were hoping next year to see the first-ever peaceful handover from one elected president at the end of his constitutional term to another. Instead, they have witnessed an ominous rise in political recrimination and violence.

Already, three gubernatorial aspirants have been assassinated. Politics has become blighted by a bitter clash between Mr Obasanjo and his vice-president, Atiku Abubakar, who are now trading accusations of

corruption against each other. Relations between the two deteriorated after Mr Obasanjo's bid, earlier this year, to alter the constitution in order to allow him to run for a third term of office. Mr Abubakar resisted this, saying that it proved the president was bent on exercising “absolute power”. Despite bribes of up to 50m naira ($400,000) to senators, and what an Abubakar ally, Usman Bugaje, the chairman of the House of Representatives committee on foreign affairs, alleges were texted death threats that the “government was obviously involved in”, the Senate voted against the bid.

The affair seemed to mark the beginning of a vendetta against Mr Obasanjo's political opponents and a return to the bad old days of Nigerian politics, with summary arrests of Abubakar supporters and break-ins at his campaign headquarters. The intention is clearly to knock Mr Abubakar out of contention for the presidential nomination of the ruling People's Democratic Party (PDP), from which he has been suspended. But with Mr Obasanjo yet to say whom he favours to succeed him, dozens of other candidates are now proclaiming their own presidential ambitions, further splitting the political elites and confusing the PDP succession.

All this has prompted real concerns as to whether an adequate election will be held at all. The government body that organises the election is in a mess; it is under-funded and way behind in its task of registering voters. Jibrin Ibrahim, director of the Centre for Democracy and Development, argues that “these elections are being programmed to fail”.

He outlines a scenario in which the poll is so violent and chaotic that Mr Obasanjo will have a pretext for declaring a state of emergency and extending his rule. That would plunge this huge and divided country, with its 250-odd ethnic groups, into a state of virtual civil war. The president's opponents would take up arms and the insurgency in the south would intensify.

That Mr Obasanjo may be flirting with such a destructive legacy is a huge disappointment to those millions of Nigerians who thought that here, finally, was a leader intent on tackling the country's deep-rooted problems, most of which stem from the “curse of black gold”. Nigeria is a classic case of the affliction. Despite billions of petrodollars flowing in since the 1970s, Nigerians are considerably worse off today than they were in 1980. About 71% of them live on less than $1 a day, infant mortality is high and the country is unlikely to achieve any of the UN's millennium development goals by 2015.

The oil bonanza encouraged gross economic mismanagement. Take oil itself. Despite pumping out about 2.4m barrels a day of the stuff, Nigeria imports most of its oil products as its refining capacity remains small and antiquated. Agriculture was a flourishing export earner at independence in 1960, but Nigeria is now the second-largest market in the world for rice.

Taking on the big men

Even more than plain mismanagement, it is the corrupt politicians, the “big men”, who have squandered the oil wealth. Corruption may have cost the country as much as $400 billion since independence, equivalent to about two-thirds of all the Western aid given to Africa during the same period. It is Mr Obasanjo's fight against corruption that has galvanised Nigerians, especially since his re-election in 2003.

Several new government agencies have been set up to fight corruption, but it is the Economic and Financial Crimes Commission (EFCC) that is capturing most of the headlines. The head of the EFCC, 45-year-old Nuhu Ribadu, has become a folk-hero to ordinary people. He blazes with passion about his job, for which, he says, he and his 1,000 hand-picked agents are “willing to die”—and two already have, he says. In the first three years of its existence the EFCC already has 91 convictions to its name and sent about 2,000 people to prison; nobody had ever been found guilty of corruption in a civil court before.

Now the EFCC is attacking the politicians themselves, the people at the core of the corrupt patronage system. Most important, it is going after the 36 state governors, 33 of whom Mr Ribadu says are under investigation. In Nigeria's federal system, they run their states like personal fiefs. They do not have to be responsive to voters as they receive almost all their money from the central government's oil fund, and it is at this level that most of the corruption goes on. The resulting inequalities and injustices provoke and fuel insurgencies like the one in the Delta.

Look at the Ogoni people, for instance, in the Delta's oil-rich Rivers state, which between 1999 and 2004 received just over $1 billion in oil revenues from the government. Ogoniland was where the campaigns first started against the environmental effects of drilling; one Ogoni leader, Ken Saro-Wiwa, was executed by the government of Sani Abacha for his protests in 1995. Drilling stopped in the area in 1993 but today the people still live in dire poverty, in the middle of putrefying oil slicks, despite promises to clean them up. In one village, K-Dere, an Ogoni leader, David Fulbel, says that the state government has never built any schools or hospitals for them. The villagers may have 48 oil wells in the area, but only two boreholes for water, both sunk by themselves. There are power-lines, but they have not carried any electricity for a year.

Meanwhile, about 30 minutes (and five checkpoints) up the road in the shiny new state house in Port Harcourt, the legislators have bought themselves some new toys. Last year $11m went on a new “executive aircraft” which officials claim is an “air ambulance”; $21.4m was set aside for the “purchase of a helicopter”. The budget also included “gifts and souvenirs to visitors” worth $3.6m. Lucky visitors.

The Ogoni argue that they have no hope of voting any of these legislators out of office. The last local elections in 2003, organised by the state, were so rigged that European Union election observers agreed that they failed to meet even “minimum standards for democratic elections”. Ogoni leaders have chosen a peaceful path to redress their grievances; others in the Delta, joined by criminals, are raising their own money by ransoming foreign oil-workers.

Governors are thus an important target for the EFCC. The trial of one Delta governor has already started. This week a state of emergency was declared in another state, Ekiti, after the governor, Ayo Fayose, was impeached on EFCC charges of money-laundering. In Plateau state, in the middle of the country, two people were killed by the police last week as they protested against the impeachment of the governor, Joshua Dariye. The EFCC has been accused of being high-handed and of acting only against Mr Obasanjo's political enemies, but Mr Ribadu argues that all these governors are members of the PDP. He says that the anti-corruption campaign is “the foundation for everything else in Nigeria” and that unless Nigeria changes, “black Africa will not have a chance.”

Reform in jeopardy

Other members of Mr Obasanjo's so-called “reform team” have been building on these foundations. The governor of the central bank, Charles Soludo, has rationalised the ramshackle banking sector, reducing the number of banks from 89 to 25 and closing 15 of the dodgier ones altogether. Ngozi Okonjo-Iweala, the former finance minister, restored macro-economic stability and drew up a fiscal responsibility bill that may be passed by the National Assembly. Pensions have been reformed, and the government is also opening up nationalised industries, such as power generation, to the private sector.

Together, these reforms offer Nigeria its best chance of sustained growth, clean government and democracy since 1960. On the other hand, they have not been fully institutionalised and could be reversed. That is why the succession to Mr Obasanjo is so important. Nigeria cannot afford another bad election. Nor, probably, can it afford the election of some of the current governors as the next president.

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Uganda

Will Kony come out of the bush?

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It will be hard to reconcile peace with justice in northern Uganda

IT HAS been presented as a classic struggle of peace versus justice. Talks aimed at ending one of Africa's longest and most savage civil wars are on the verge of collapse as the leaders of Uganda's rebel Lord's Resistance Army (LRA) insist that there can be no peace deal unless the International Criminal Court (ICC) drops its indictments against four of their number. The court remains adamant that there can be no impunity for crimes against humanity. But as the faltering talks limp into their fourth month, a hint of possible compromise is in the air.

For the past 20 years, the LRA has hacked and raped its way through northern Uganda, abducting thousands of children to serve as fighters and sex slaves and forcing nearly 2m terrorised Acholis to flee their homes for the relative safety of overcrowded, disease-ridden government camps. Unable to destroy the rebels by armed force or to lure them in from the bush with promises of amnesty, Uganda's government referred the conflict in January 2004 to the ICC for investigation. A year ago the court, set up in 2002, issued its first indictments for war crimes and crimes against humanity against Joseph Kony, the LRA's holy-spirit-possessed leader, and four of his henchmen (one of whom has since been killed “in battle”).

Local leaders protested that this would mean the end of the peace process that Betty Bigombe, a former Ugandan government minister, had been trying to broker for years. Ms Bigombe herself accused the fledgling court of seeking “to prove itself at the cost of peace”. Acholi delegations travelled to The Hague to beg the court to withdraw its arrest warrants and allow traditional African ceremonies of reconciliation and forgiveness to prevail instead. Even Uganda's president, Yoweri Museveni, appeared to be having second thoughts, talking at one point last year of “convincing the ICC to drop their indictment if the LRA rebels surrender”.

But the court's efforts to bring the LRA to justice have the full backing of the United Nations and human-rights groups. Even the Americans, usually fierce opponents of the ICC, have urged co-operation with its prosecution of Mr Kony. To let the LRA leaders off completely would be to send the wrong message to other potential perpetrators, they say. Besides, under international law no amnesty is possible for war crimes and other such atrocities.

With both sides digging in their heels, the peace talks, being mediated by the southern Sudanese in the town of Juba, seemed doomed to failure. Hopes were briefly raised in August when a truce was announced pending agreement on a comprehensive peace settlement, under which all the rebels were to assemble at two designated points in southern Sudan. But the four indicted commanders refused to surrender unless the ICC warrants were first withdrawn, saying they feared a trap.

Since then, each side has blamed the other for breaking the terms of the truce. Accusing Uganda of deploying large numbers of soldiers around one of the designated “safe havens”, the LRA has ordered its own troops to disperse back into the bush. Meanwhile, Uganda continues to insist that the indictments will remain in place until there is clear evidence that peace has been achieved “and that no impunity has been condoned”. At the same time, Jan Egeland, the UN's head of humanitarian affairs, talks of the need to be “creative...[and] flexible” in bringing to an end “one of our generation's worst wars”, while the ICC's chief prosecutor says that the warrants should not be “an obstacle to the peace process”.

What does all this mean? In Juba, New York and The Hague, interested parties are quietly exploring an alternative way out of the present impasse. Under the ICC's statutes, the court cannot simply drop the proceedings against Mr Kony and his henchmen unless this is deemed to be “in the interests of justice”—which it clearly is not. But it might be able to transfer the case back to Uganda for trial under some kind

of yet-to-be-devised combination of Western-style criminal justice and traditional reconciliation ceremonies.

This approach, say its advocates, could allow the hobbled peace process to proceed. But without a guaranteed amnesty, which would upset those urging accountability, such a system is unlikely to do any better at luring Mr Kony and his accomplices out of the bush and into court.

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Saudi Arabia

An uneasy crown of petrodollars

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High oil prices have brought the Saudi kingdom a windfall of cash. But they can't solve its deep-rooted problems, including its royal feuding

"NO BOMBS," declared your correspondent's Saudi taxi-driver with a toothless chuckle. "*Khalas* [finished]." Well, almost. Hotels, embassies and government buildings are still ringed with concrete blocks and approaching vehicles are searched. The last attack by al-Qaeda-linked Islamists, in February, was against a sensitive target: the world's biggest oil-processing plant, in Abqaiq, near the country's eastern coast. But the wave of bombings and suicide attacks that struck the kingdom in May 2003—claiming at the time and afterwards more than 280 lives—has largely subsided. The authorities have dismantled many of the terrorists' cells and are deploying soft power (for example, putting repentant jihadists on television and the internet) in a bid to win hearts and minds.

Moreover the country is flush with cash. Even at current levels of around $60 a barrel (a fall from the dizzy heights of $78 in July), oil exports are bringing in over $400m a day. Last year's budget surplus was a whopping $57 billion, and economists expect a similar figure this year. The government is using much of the windfall to invest in the oil sector, pay off debt and buy new weapons, and there is still plenty left over for the kingdom's education, health and welfare.

But high oil prices are bad for reform, or so goes an adage beloved of Middle East-watchers. The danger is that the ruling House of Saud will use its new petrodollar bonanza to buy off dissent and put off painful political decisions. Though there has been notable progress in opening up a hitherto insulated economy, movement towards more accountable government, never swift, has stalled.

Last year Saudis took part in their first nationwide elections, for half the members of municipal councils. But the councils met only after months of delay and they are largely powerless. The elections had been billed as the start of a process leading eventually to the partial election of the *majlis al-shura*, the advisory council whose 150 members are currently appointed by the king. But now the unspoken hope of the ruling family is that more money in the kitty will suppress the desire for royal accountability.

If more money translated into better schools and hospitals—and, above all, more jobs for Saudis—that might be a more plausible argument. But the impressive infrastructure built in the 1970s during the first oil boom is starting to look threadbare, and the country's oil wealth is still very unevenly distributed. Leave the glitzy heart of Riyadh or Jeddah, the two main cities, and you find down-at-heel suburbs where poor Saudis live side by side with poor Asian and African workers.

Saudi unemployment, an oddity in such a rich country, is now on everyone's minds. The man entrusted with eliminating it, Ghazi al-Gosaibi, the labour minister, is a polarising figure. Liberals see him as a brave and energetic reformer, religious conservatives as a brash secularist who has grown too big for his boots. One young Islamist businessman refers to him sourly as "the uncrowned king of Arabia".

In any case, the challenge of replacing some 6m foreign workers (about a quarter of the population) with Saudis is proving intractable. Mr Gosaibi faces opposition from two quarters: the private sector, which would rather employ cheap, hard-working foreigners than expensive, leisure-loving Saudis; and conservatives riled by his efforts to bring more women into work (women account for 55% of graduates but only 5% of the workforce).

There is another obstacle. Without an overhaul of the education system, universities will continue to churn out unemployable young people. But religious conservatives resist root-and-branch reform of a sector they regard as one of their strongholds. There are already signs that unemployment is contributing to a rise in crime, drugs, divorce and other social ills—and making young men more vulnerable to the

appeal of religious extremism.

That is only one reason why the relative lull in Islamist violence may not last. Another is that Saudis share the virulent anti-Americanism of other Arabs, a sentiment fed by the chaos in Iraq. Officials worry that young Saudis who have gone there to wage *jihad* will return home to revive the domestic insurgency. Moreover, it is too early to tell whether the authorities really are, as they hope, taming the wilder fringe of Wahhabism (the kingdom's austere brand of Sunni Islam) whose networks of mosques and charities have traditionally formed a bedrock of support for religious extremism. The jihadists are adept at playing a long game. Even if driven underground for a while, they have an unsettling habit of bobbing up later.

These are challenges which require firm leadership. But while King Abdullah, who succeeded to the throne last year, is undoubtedly popular, his position is vulnerable. First, he is 83 and his advisers are said to be worried about his health and his ability to manage the royal workload. Second, he faces the rivalry—and on some issues the opposition—of an alliance of powerful senior princes.

These include his half-brothers: Nayef, the interior minister, Sultan, the crown prince and defence minister, and Salman, the governor of Riyadh. Each of these princes has his own fief with an extensive network of power and patronage.

The king's allies, a coalition of liberal princes and technocrats such as Mr Gosaibi, are weak by comparison. And though Abdullah himself is in favour of gradual reform (including reform on such sensitive issues as women's rights), his rivals tend to equate reform with weakness. Princely feuding is not uncommon in the kingdom. But it carries the probability of political paralysis—and the further danger of an uncertain succession.

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Israel

Arkady the kingmaker

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Israeli politics swirls with intrigue

SINCE the ill-fated war against Hizbullah in Lebanon, Israeli politics has been in turmoil. A poll last week in the *Yediot Achronot* newspaper found that in an election now, the centre-right Likud and the nationalist, Russian-speakers' party, Yisrael Beiteinu, would get 22 and 20 seats in parliament, roughly double what they have now, while Kadima and Labour, the main parties in the governing coalition, would drop to just 15 seats each.

Adding to the public's lack of faith in politicians is a string of scandals. This week two ministers began criminal trials: one for sexual harassment, the other for corruption in handing out jobs. And the police, after a long investigation into allegations against Israel's president, Moshe Katsav, by women on his staff, recommended that he face charges of rape (though unless he steps down, he cannot be tried until his term ends next August).

AFP

Watch my lips, says Mr Gaydamak

Ehud Olmert, the prime minister and head of Kadima, is now looking to shore up the coalition. Speculation about possible alliances fills the press. The commonest, and most controversial, is the idea that Yisrael Beiteinu could join the government; its head, Avigdor Lieberman, has advocated stripping some Palestinian Israelis of their citizenship and transferring the towns they live in to the Palestinian Authority. Labour's members, already divided over the dismal performance of Amir Peretz as party leader and defence minister, are even more split over Mr Lieberman. Some say letting him join the coalition is abhorrent; others argue that by keeping him out, they risk an early election that could bring Yisrael Beiteinu to power anyway, in partnership with the Likud.

Watching it all with wry amusement from his imposing villa in the seaside town of Caesarea is Arkady Gaydamak. The Russian-born billionaire, who emigrated to Israel in 1972 at the age of 20 but has spent most of his adult life in Europe, has a sordid reputation among the country's intellectual class (he has faced investigations for money-laundering both in Israel and in France, which tried unsuccessfully to extradite him).

But among the urban poor, he has been winning support with a string of investments. As well as buying Jerusalem's Beitar football club, he set up a tent city for refugees from the north during the Lebanon war and is now planning to build cheap housing for new immigrants. A poll this month named him “Man of the Year”.

Mr Gaydamak insists that what makes him popular is not his munificence but his ideas, namely that Israel is in great danger as a result of the botched Lebanon war. Another *Yediot* poll showed that if he formed a party, it would win eight seats—at the expense less of Mr Lieberman, his fellow Russian émigré, than of the Likud, the traditional party of the poor. There have been rumours that he might join forces with either of them.

But Mr Gaydamak has other ideas: his voice as a citizen, he argues, is stronger than any party. “If I express my opinion to the voters on which way to go,” he says, “they will follow me. I am the main piece in deciding the next Israeli government.” In a tight enough race, that could be true. And what would he decide? There are two politicians he considers “more responsible than those in power”: the Likud's leader, Binyamin Netanyahu, and Ami Ayalon, a former intelligence chief, in Labour.

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Turkey

Troubles ahead

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AP

There may be serious fall-out from Turkey's present poor relationship with both the European Union and America

“THERE'S a lot of talk these days of a train-wreck later this year bringing Turkey's negotiations for membership [of the European Union] to a shuddering halt. Is this exaggeration? Or just brinksmanship? Neither, I fear. The danger is real.” These valedictory words from the outgoing British ambassador, Sir Peter Westmacott, reflect a growing concern over Turkey's relationship with the EU.

The trigger for the looming derailment is Cyprus, which joined the EU as a divided island in 2004. The EU insists that Turkey must honour its pledge to open its ports to Greek-Cypriot ships and aircraft. Turkey retorts that part of the deal was to end the economic isolation of the Turkish-Cypriots. It will not budge on the ports until the embargo on Turkish-occupied northern Cyprus is lifted. If this row is not settled by the end of the year, the EU membership talks may be suspended.

A longtime NATO ally, Turkey's strategic importance and size mean that a rupture with the EU would have effects far beyond its borders. It would confirm suspicions across the Islamic world that the union is a Christian club. Mindful of the stakes, Finland, which holds the EU presidency, has been pushing a plan that would let Greek-Cypriots use Turkish ports and Turkish-Cypriots export their goods, under union supervision, from the Turkish-controlled port of Famagusta. This week Abdullah Gul, the Turkish foreign minister, and Ali Babacan, the economy minister and lead negotiator with the EU, both said they were hopeful of a breakthrough before the European Commission issues its progress report on Turkish accession on November 8th.

In private, Turkish officials say that any deal would have to include reopening northern Cyprus to commercial air traffic, because tourism is the only way of ending its dependence on handouts from Turkey. And the Greek-Cypriots say this is out of the question so long as Turkey refuses to recognise their government as the only legitimate one on the island.

Barring a last-minute miracle on Cyprus, the best hope is that negotiations are allowed to continue on chapters that are unrelated to trade or other matters that affect the Greek-Cypriots directly. But that means persuading the Greek-Cypriots to lift their veto on opening new chapters. And the suspicion in

Ankara is anyway that countries such as Austria and France, where there is strong public resistance to Turkish accession, would be only too happy to see the talks suspended.

How else, say the Turks, can one explain the French National Assembly vote for a bill to criminalise denial that the mass slaughter of the Armenians by the Ottoman Turks in 1915 was genocide? Or the demands by French politicians that recognition of the genocide should be made a condition for Turkey's membership, even though the enlargement commissioner, Olli Rehn, has firmly declared that it should not be?

Given the public response in Turkey to what are seen as European snubs, some are now speculating that it will be Recep Tayyip Erdogan, the Turkish prime minister, who is the first to walk away from the talks. With support for EU membership dipping below 50%, a firm show of defiance might be a good way of drawing nationalist votes to Mr Erdogan's mildly Islamist AK party in the parliamentary election that is due by next November.

As ever, pro-European Turks are pinning their hopes on America to ride to the rescue. The economic and political ructions that many fear would follow a suspension of the EU membership talks might galvanise America into using its influence with heavyweights such as Germany's chancellor, Angela Merkel, who is due to assume the EU presidency in January.

The trouble is that Mr Erdogan now has so few friends left in Washington. His failure to deliver on promises to facilitate America's invasion of Iraq and his overtures to Iran and Syria have made him seem an unreliable partner. This matters as America ponders the best response to Iran's nuclear ambitions.

At home too, Mr Erdogan is facing problems with the country's hawkish new chief of the general staff, General Yasar Buyukanit. Since taking over in August, the general and his fellow commanders have turned up the volume of rhetoric they aim at both the government and the EU. When Mehmet Agar, leader of the opposition True Path Party, declared last week that he would not allow the generals to talk when he came to power, General Buyukanit responded that he would continue to talk “even if you are in charge.”

The army's assertiveness is aimed in part at bullying Mr Erdogan into renouncing his presumed ambitions to succeed the determinedly pro-secular Ahmet Necdet Sezer as president when his term expires in May. Mr Sezer has spent the past three years blocking any legislation proposed by Mr Erdogan that he has deemed to be a threat to the secular tenets of the constitution. For secularists the presidency is their sole remaining bastion; should the overtly pious Islamist Mr Erdogan conquer it, they fear that it will be the end of Ataturk's republic. The knee-jerk anti-Semitism displayed by some of Mr Erdogan's colleagues has not helped him.

General Buyukanit may well be tempted to voice these concerns when he visits Washington shortly. His views on Iran (he once described Iran's theocracy as the “antithesis” of Ataturk's republic) will undoubtedly appeal to his hosts. Should the EU talks collapse, the army may be given an even freer hand. There is loose talk of a repeat of the generals' so-called “soft coup” in 1997, when they managed to lever Turkey's first Islamist-led government out of power.

Yet although some in America might be tempted to welcome such an outcome, the chances of its happening remain tiny. Unlike 1997, the opposition parties lack the parliamentary strength to form a government. Foreign investors, crucial to sustained economic growth, would take fright if the army moved. Another risk is that opposition to a military-backed government would no longer come only from mainstream Kurdish and Islamic groups, but from their militant hardcore detractors, with suspected ties to Islamist terrorists.

That such scenarios are now seriously conjured up only goes to show that EU membership, warts and all, is the best—and possibly the only—guarantee of Ataturk's dream of a firmly pro-western democracy. With the right vision and selfless leadership Mr Erdogan could still go down in history as the man who made it come true. But he will have to show statesmanship—and the EU (and America) will have to help him along the way.

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Turkey and the Armenians

A prize affair

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Orhan Pamuk, the French parliament and the Armenian massacres

WAS it for his writing or his commentary? The question has consumed the country since Orhan Pamuk became the first Turk to win the Nobel prize for literature (or indeed any Nobel). The comments, about the mass slaughter of Armenians by the Ottoman Turks, led last year to Mr Pamuk's prosecution on charges of insulting the “Turkish identity”. The charges were later dropped on a technicality, but not before they had attracted a storm of international criticism.

Ascribing to him the Byzantine wiles displayed by some of his characters, Mr Pamuk's enemies are now saying that he engineered his own trial so as to win the Nobel. Recep Tayyip Erdogan, the mildly Islamist prime minister, urged fellow Turks to “put aside polemics” and congratulate Mr Pamuk, but the (pro-secular) president remained pointedly silent.

The novelist's detractors were given a boost, hours before the award was announced, by the French National Assembly, when it voted overwhelmingly for a bill to criminalise denial that the Armenians were victims of a genocide. The bill is unlikely to become law, but it still sparked a wave of anti-French demonstrations and vows that France would somehow be made to “pay” for its misdeeds. Why not boot out some 70,000 illegal workers from neighbouring Armenia, suggested Yasar Yakis, a former minister from the ruling AK party?

The European Union enlargement commissioner, Olli Rehn, said that the French bill “instead of opening up the debate [on the Armenians in Turkey] would rather close it down.” Mesrob Mutafyan, the Armenian Orthodox patriarch in Istanbul, voiced fears that his 80,000-member flock might now become targets for ultra-nationalist vigilantes. Happily, no Armenian has been hurt (or deported) so far. Nor have efforts to break the ice between ordinary Turks and Armenians stopped—an exhibition by Turkish and Armenian photographers depicting daily life in Istanbul and Yerevan is to open soon.

There may even be a silver lining to the French cloud. Basking on the moral high ground, Mr Erdogan said he would not be trapped into responding to France's “assault on free speech” in kind. The justice minister, Cemil Cicek, is hinting that Turkey's article 301, under which Mr Pamuk and scores of fellow writers and academics have been prosecuted, may be scrapped. If it is, Turkey's EU hopes would be resuscitated—and future award-winning novelists could then claim to have been judged solely by their works, not their deeds.

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Germany's ex-chancellor

Schröder revisited

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A memoir rekindles a debate

AFP

WHAT might have happened had Gerhard Schröder, Germany's former chancellor, not gone for an early election last year? He could have won a third term in September, when the vote was due. In the year since he left politics, everything has gone his way, not least the economy and the World Cup. Had he waited, the Christian Democrats (CDU) might have helped by indulging in a bout of infighting over their candidate for chancellor.

So when Mr Schröder releases his memoirs, "Decisions: My Life in Politics", next week, critics will search for an answer to one question: why did he not try to hold on? They will not find it convincing. A more pointed question today is: can he ever become an accepted elder statesman?

After leaving office, Mr Schröder's first goal seemed to be to monetise his reputation even if that meant destroying it. He appeared to accept every offer that came along. What really hurt was his taking a job, for €250,000 ($300,000) a year, as chairman of the Gazprom subsidiary that is building a pipeline between Germany and Russia. This huge project was agreed only a few weeks before the election.

Nor have Mr Schröder's political forays won him much sympathy. His bid to remain as chancellor of a grand coalition after the election seemed arrogant. Predictably, he has continued to defend Vladimir Putin, Russia's president, whom he called a "democrat through and through" when he was still in office.

Mr Schröder's memoirs can best be seen as a bid to rebuild his reputation. The book launch recalls an election campaign. In recent days, he has been in the headlines with seemingly innocent stories, such as the Schröders' decision to adopt a second Russian child. Next week *Bild*, a tabloid daily, and *Der Spiegel*, a weekly, which were both big critics of Mr Schröder at the end of his tenure, will publish extracts from his book. And there will be a barrage of television appearances, high-profile readings and book signings.

Although a historian might have preferred Mr Schröder to wait a few years before writing his memoirs, his political timing could hardly be better. Amid the travails of the grand coalition, Germans are no longer in love with their CDU chancellor, Angela Merkel. And, although debate is raging over whether his reforms lie at the root of today's rising poverty, in general Germans view Mr Schröder's tenure more leniently than they did a year ago.

The public could be disappointed, to judge by Mr Schröder's recent meeting with Joschka Fischer, his Green foreign minister, in a Berlin restaurant. Teased that he would have been heading for re-election, he said that neither his party's left wing nor the CDU state premiers would have let him hang on. To get the truth about last year, readers may have to wait for other efforts, not least Mr Fischer's.

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Italy's government

A liberal puzzle

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From The Economist print edition

Romano Prodi tries to combine economic reforms with higher taxes

EMPLOYEES of Italy's flag-carrier, Alitalia, are seething over the apparent readiness of Romano Prodi's centre-left government to let the airline go bust. Many Sicilians are furious that the government has scrapped the planned Messina bridge to link their island to the mainland. And last week, tens of thousands of irate, grey-suited members of the professions marched through Rome to demonstrate against liberalisation measures.

At first glance, all these protests sound promising enough. Mr Prodi won power in April with pledges of real reform. Italy badly needs less regulation, more competition, lower taxes and less public spending. That the government is now under fire from all sides might be seen as evidence that it is giving the country some of the reforms that it needs.

Its popularity has plummeted, of course. Earlier this month, a poll in *La Repubblica* showed the government's approval rating had collapsed since July, from 59% to 39%. But, as Mr Prodi himself said in an interview with *El País*, a Spanish newspaper, the trick with unpopular reforms is to get them out of the way as soon as possible before the next election.

His government is unquestionably doing some things right. It has shown itself ready to take on some of Europe's most cosseted professional groups. On October 12th it approved a bill to erode the near-monopoly over private television exercised by the opposition leader, Silvio Berlusconi, who controls three of Italy's four main private channels. The proposed law, decried as “banditry” by Mr Berlusconi, would require one of his channels to go digital, together with a publicly owned one; and would offer the frequencies this frees up to new entrants.

There has been a welcome whiff of liberalism too in the government's approach to Alitalia, whose huge losses have previously been meekly underwritten by successive administrations, including that of the supposedly free-market Mr Berlusconi. “The situation is totally out of control and I don't see any parachutes,” Mr Prodi told the trade unions last week. Even his transport minister, a communist, is against further subsidies. Nor has the cabinet balked at axing infrastructure plans such as the Messina bridge and funding for a barrier scheme to protect Venice.

Its biggest reform, though, may be one taking place silently and without high-profile legislation: a clampdown on tax evasion. The government hopes that this will net more than €7 billion ($9 billion) next year. “The future of the country is at stake in the war on tax-dodging,” Mr Prodi said this week. “All else is secondary.”

That may seem absurdly hyperbolic. But the drive against tax dodging has a political significance that could outstrip its revenue-yielding capacity. In a country where the self-employed have traditionally declared a small fraction of their earnings, it is potentially powerfully redistributive. What really brought many of last week's protesting professionals out on the streets was the threat of having to pay taxes that employees cannot escape. Their ire helps to comfort the powerful left of Mr Prodi's heterogeneous administration, and may even give him enough leeway to pass other liberalising reforms.

Yet there are risks in all this. The most obvious is that the attack on tax evasion will be no more successful than previous crackdowns in getting Italians to start paying their taxes in full. But another risk is that, if it does work, it could induce the government to keep relying on higher tax revenues not spending cuts to sort out its public finances. If that happens, it could hold back growth.

The warning signs are all there in the draft 2007 budget. Mr Berlusconi claims to have found 67 new

taxes hidden in the small print. In his evidence to parliament on October 12th, the governor of the Bank of Italy, Mario Draghi, said gloomily that the budget left the trend of current spending “substantially unchanged”, an implicit criticism. Is it possible to be a “tax and spend” liberal reformer? Romano Prodi seems determined to give it a try.

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French icons

Liberation, Equity, Sobriety

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Attacking the things that make France French

ONE by one, icons of the French way of life are under attack. The government is to ban smoking in public places, threatening an end to the smoke-filled café beloved of students. Speed cameras on motorways are bringing to a halt the annual August carnage as families rush to the beach. Now it looks as if *Libération*, a newspaper founded by Jean-Paul Sartre that is the bible of the left-bank intelligentsia, could be heading into history. What is happening to France?

The first two reflect health-and-safety worries. The decision to ban smoking in public places from February 2007, and from cafés and restaurants a year later, is meant to curb France's high lung-cancer rate; the government blames smoking, directly or indirectly, for 65,000 deaths a year. It is a similar tale for speed cameras. In 2001 the French were traffic-accident champions, killing over 8,000 people on the roads. Between 2003, when the first cameras were installed, and 2005, the annual number of deaths fell to just above 5,000.

The ill health at *Libération* is financial. The paper, founded in 1973 by Sartre and some French Maoists, is losing readers and money in equal measure. Sales have fallen by 20% since 2001, to 140,300; the paper will lose €13m ($16m) this year. Edouard de Rothschild, who owns 39% of the paper, may soon have to put in yet more cash. Serge July, its longtime editor, has already been evicted; other journalists have left, bemoaning a new capitalist culture. Many fear that the paper's days are numbered.

A common element to all of these is the disappearance of what makes France French. Two factors are at work. One is an assault on individual freedom, in the birthplace of liberty. France, with its strong state, has always imposed rules on its citizens. But, when it came to life's pleasures, the French have been free to enjoy, or wreck, their lives with abandon. Now prostitutes have been chased from the streets; the legal age of marriage has been raised from 15 to 18; G-string bikinis were even banned from Paris-Plage, the summer-long riverside festival.

The second factor is creeping globalisation. *Libération*'s troubles affect many newspapers: the internet, the loss of young readers and advertisers. Globalisation often means Americanisation. The French elite profess hostility to America, but ordinary folk lap up Americana. Two of the top three box-office hits this year are Hollywood blockbusters. France is one of McDonald's biggest and most profitable markets. Even the baguette is under attack from *le sandwich*, often made from “Harry's American Sandwich” bread, a sliced product wrapped in decidedly unFrench plastic bags. Not exactly food for existential thought—especially in a smoke-free café.

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Macedonia and the European Union

Not so fruity salad

Oct 19th 2006 | SKOPJE AND TETOVO
From The Economist print edition

Another troubled Balkan candidate for the European Union

WHICH countries will be next in line for membership of the European Union, after Bulgaria and Romania join in January? Many people would answer: Croatia and Turkey, which are now in negotiations. Few would remember Macedonia, a poor, land-locked country of 2m people, with a stagnant economy, which has been offered membership talks but no firm date for starting them. Macedonians have got used to being unloved and ignored. What is more annoying is that the world notices them only when bad things happen.

Officially, at least, good things are now happening. In 2001 Macedonia went to the brink of civil war when a guerrilla army sprang out of the ranks of the ethnic Albanians who make up 25% of the population. The EU, the Americans and NATO rushed to damp the fire, producing the Ohrid agreement, which has proved a success in keeping the peace. What has been a failure is the economy. More than a third of the workforce is unemployed and, except for some biggish privatisations, there has been little foreign investment.

All of which makes it unsurprising that, in July, the electorate turned against the Social Democrats, ruling in coalition with a party led by Ali Ahmeti, who led the Albanian guerrillas in 2001. Diplomats have since been falling over themselves to praise the peaceful transfer of power to a new centre-right coalition under Nikola Gruevski. In public, that is. In private, there is rising concern about Macedonia. Were it a bigger place—or already in the EU—it might have received the sort of attention that has recently been given to Poland or Hungary. For Macedonia too is in the throes of a political earthquake.

The big bone of contention is the government. Mr Gruevski's party needed an Albanian coalition partner (as elsewhere in the region, people vote on ethnic lines). He struck a deal with the smaller of the two main Albanian parties, much to the fury of Mr Ahmeti, whose party won more than 60% of the Albanian vote. He is now arguing that Albanians must wonder what is the point of voting at all, if a Macedonian gets to choose which Albanian party keeps him in power.

Mr Ahmeti's anger is not just about his interpretation of democracy. To be out of power in Macedonia means to be out of patronage. Within three days of the new government taking office in August, as many

as 544 managers and top officials from state companies had been sacked or shunted aside. Hundreds of civil servants have been replaced by loyalists to Mr Gruevski's party or to his Albanian partner. The purge has extended right down to lucrative positions manning motorway toll-booths.

The government insisted that it had to replace all these people as part of its bid to stamp out corruption. In fact, says one well-placed senior Macedonian, “it is the nature of things here that you have to replace everyone around you, because otherwise they will do everything in their power to discredit you. People are dedicated to their parties, not to their country.”

One group caught in this argument over power is Transparency International, a German-based anti-corruption lobby group, which has been an influential voice in Macedonia. Transparency has just announced that it is withdrawing its accreditation of the local branch in Macedonia, though it added it hoped to set up a proper operation again.

Gabriela Konevska-Trajkovska, the minister in charge of European integration, was previously, albeit briefly, head of Transparency International in Macedonia. She hopes negotiations on EU membership can start in 2007. EU officials say this is realistic—so long as the country does what it is asked. But for now, they are hopping mad. Many of the people they had trained over the past few years to deal with intricate details of EU rules and regulations have been replaced.

In Tetovo, the western Macedonian town where most Albanian politicians are based, Mr Ahmeti says that former fighters have been coming to him to suggest that, unless his party is taken back into the government, they should take up arms again. He has told them to keep their cool but adds that he cannot take responsibility for the results if his party continues to be ignored. Yet the implied threat is probably an empty one. Whatever else may happen in Macedonia, there is no appetite for a return to armed conflict.

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Charlemagne

Free speech under threat

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What Britain's debate about the Islamic veil has in common with France's bill on Armenian genocide

IN 1999 Jack Straw, then Britain's home secretary, was attacked for being rude about an ethnic minority. There were demands for criminal investigations, appeals to various commissions and public agencies, a fevered debate over whether Mr Straw was racist. On that occasion, he was accused of demeaning gypsies by saying that people who masqueraded as travellers seemed to think they had a right to commit crimes. In the past few weeks Mr Straw, now leader of the House of Commons, has triggered a similar response by arguing that the Muslim veil (ie, the full, face-covering *niqab*) is an unhelpful symbol of separateness. This week he won the backing of his boss, Tony Blair.

These episodes are reminders not that Mr Straw is hostile to minorities (he isn't) but that any debate in Europe about minority rights soon degenerates into a fight between self-proclaimed community leaders, public agencies, the police, courts and the law. It may be hard to reconcile militant Islam with secular Europe. But Europeans have fostered a culture, legal system and set of institutions that have a chilling effect on public debate, making it hard to discuss the subject honestly.

The starting-point of this failure, argues Gerard Alexander, at the American Enterprise Institute, is a surprising one: Holocaust-denial laws. At the height of this year's row over cartoons of Muhammad in a Danish newspaper, devout Muslims argued that, if it was right to limit free speech in one area, it was right to do it in another. They wanted insulting the Prophet to be made a crime.

Restrictions on free speech are always undesirable. Holocaust-denial laws may have been justified in Germany and Austria because they helped to stop something even worse: a revival of Nazism. Yet that is surely no longer a risk in either country. And it certainly does not justify the extension of such laws to other countries where there is no real threat of Nazism, such as France and Belgium; or the adoption of “hate speech” legislation that has nothing to do with Nazism; or the interpretation of laws against incitement to violence in a way that constrains speech which merely causes offence.

The most vivid example of the creeping extension of Holocaust-denial laws has come in the French National Assembly, which last week voted for a bill to make denial of the genocide of Armenians in Turkey during the first world war a criminal offence. The political context for this was not just vociferous lobbying by Armenians in France but also growing hostility among voters to the idea of Turkish membership of the European Union. To appeal to such voters, the assembly proved ready to place restrictions on one of the most fundamental of all freedoms, that of speech (though in fact the bill is

unlikely to become law).

This is a perfectly logical extension of a slew of laws imposing free-speech restrictions to suppress racial, ethnic and religious hatred. Indeed, it may be an offence to deny the Armenian genocide in France already, because its Holocaust-denial law was extended in 1990 to cover all crimes against humanity. Bernard Lewis, an American historian, was condemned by a French court in 1995 under this law. Britain also has laws against incitement to racial hatred; last January it tried but failed to extend them to religious hatred. On the face of it, then, it does not seem outlandish for Muslims to demand that Islam be equally “protected” under speech-restricting laws.

Laws against racial and religious hatred are often defended on the ground that they are directed at racists and xenophobes. Certainly, they have been used against such people. In 2004 Belgium's highest court found a Flemish far-right party, the Vlaams Blok, guilty of racism, forcing it to disband (though it regrouped under a new name). But such laws have not been restricted to the far right; they have been used against pillars of society. Mr Lewis is a frequent guest of both the Jordanian royal family and the White House. Last year, a French court found *Le Monde*, the *grande dame* of French newspapers, guilty of inciting hatred against Jews. Oriana Fallaci, one of Italy's best-known journalists, was awaiting trial for offending Islam when she died. Such lawsuits do not discourage racists; they discourage free speech.

Fighting for the right to speak

As always happens, an industry grows up around any such laws (and lawsuits), dedicated to policing, sustaining and extending the legal framework. The industry consists of government bodies, such as Britain's Commission for Racial Equality, which investigate complaints; official agencies, such as France's Conseil Supérieur de l'Audiovisuel, which monitor the media for racist remarks; and any number of informal organisations that represent minorities and win their spurs by doing battle with the political establishment.

Laws against incitement to hatred tend to hamper openness of debate because they are too easily interpreted as laws against causing offence. The placing of sanctions on “offensive” speech risks conflating two different things: bigoted speech and constructive criticism. The big danger is that, in the name of stopping bigots, one may end up stopping all criticism.

The outcome is an odd combination, whereby Europe simultaneously suppresses but also radicalises its debate about Islam. Acts of self-censorship co-exist with fevered argument. Spain's folklore festivals may rid themselves of medieval depictions of Muhammad and the Deutsche Oper in Berlin may cancel a production for fear of Islamist reprisals. But at the same time, extremists exploit arguments over the veil in Britain or over the pope's reference to a 14th-century Byzantine emperor.

The good news is that politicians have begun to recognise the risk of stifling debate. Germany's Angela Merkel criticised the opera house for self-censorship. Most of Mr Straw's cabinet colleagues, and not only Mr Blair, have rallied to support him. They are right to. It is hard to integrate Muslims into European society. Restricting free speech makes it even harder.

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The super-rich

Always with us

Oct 19th 2006
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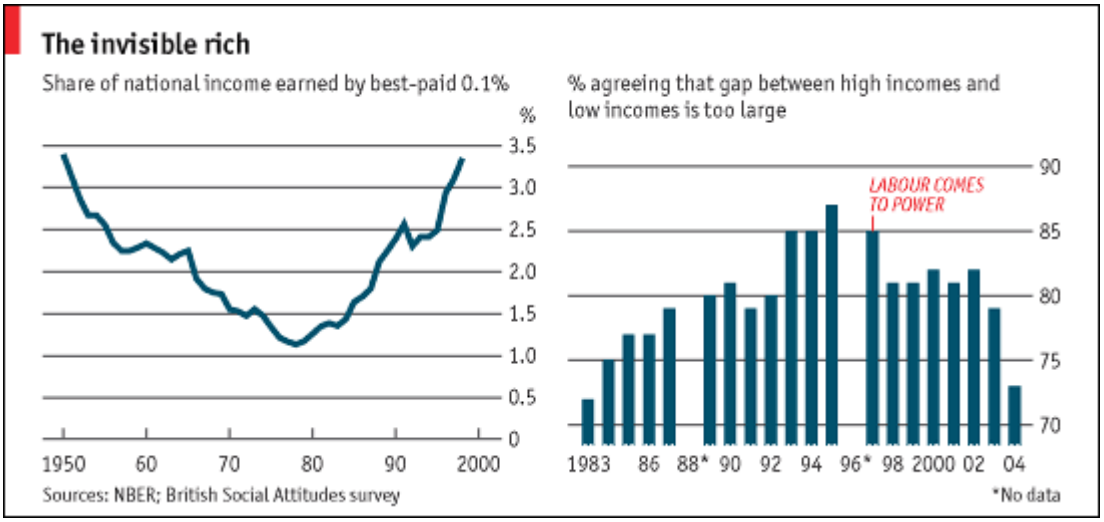
The rich are richer but, oddly, nobody seems to mind

AFTER the Big Bang rescued the City of London, Britain's most dependable creator of large fortunes, from a dreary decline 20 years ago, a new kind of spending briefly flourished. Yuppies used primitive mobile phones to broadcast their wealth, gargled with ancient clarets and drove sports cars with spoilers as broad as the steps down into their new swimming pools. There was even a bond-dealers' ball, in imitation of the parties thrown by junk-bond dealers in Los Angeles. It was, people noted at the time, very un-British. When the stock market crashed in 1987, speeding the yuppie's demise, the pleasure taken in the extinction of this exotic species revealed how little attitudes to wealth in Britain had changed.

Since then, the fortunes of the super-rich have improved. By the late 1990s, the best-paid 0.1% of earners were pocketing as large a slice of national income as they were in 1950 (see chart). These days, they seem to be doing better still. This year's City bonuses are again set to break records. William Rubinstein, a historian at Aberystwyth University who studies wills, reckons that since 1990 the super-rich have increased their wealth by between 500% and 600%. The retail price index rose by 60% over the same period.



Yet, though their fortunes are bigger, today's super-rich are largely left to enjoy their loot unmolested either by politicians or by the press—unlike the yuppies of the 1980s or the unpopular “fat-cat” chief executives in the 1990s. According to the British Social Attitudes survey, the proportion of people who believe that differences in income are too large fell from 87% in 1995 to 73% in 2004.

One reason is that, even compared with ten years ago, more of these fortunes have been earned. Philip Beresford, a professional compiler of rich lists (including a yearly one for the *Sunday Times*), says that when he started counting in 1989, about three-quarters of the fortunes he unearthed had been inherited. Since then his list has expanded from the 200 wealthiest to the top 1,000, which makes direct comparisons hard. But he reckons that work overtook inheritance as a source of fortunes in the mid-1990s. His most recent list shows that over 70% of the 1,000 biggest have been made by their owners.

Three types of wealth stand out. First comes money made in the City. There are currently some 2,000 people working in financial services in London who between them have made around £7 billion ($13 billion), or £3.5m each, according to Christian de Juniac of Boston Consulting Group, which produces an annual wealth report using data from a private bank. Over the past decade the City has become a much more international place: since 1995, the number of work permits granted for financial-services jobs has doubled. As a result, there are many more self-made City rich who are not British citizens.

Second comes wealth created by people who started their own businesses. The row over political party funding that broke earlier this year, when Labour owned up to taking money from large donors who, by a strange coincidence, were also nominated for seats in the House of Lords, provided a snapshot of them. Of the 12 people who lent Labour £250,000 or more, 11 had started their own businesses. Two were south Asian immigrants. Mr Rubinstein reckons that the pattern of wealth-ownership in Britain now resembles the mid-Victorian era, when fortunes created in the City vied with those made by foreign-born entrepreneurs.

The third group is made up of people who were rich before they arrived. Rich people can be resident in Britain without being domiciled, meaning that they only pay tax on income earned in Britain. That's not the case in other developed countries. Christian Kalin of Henley and Partners, a firm that helps wealthy people to move, describes this as “probably the biggest tax loophole in Europe.” The government occasionally mutters about closing it. But it is aware that London's 1,500 wealthy non-domiciled residents—who, according to BCG, are collectively worth £28 billion—would catch the next private jet out. So it has resisted. The presence of the “non-doms”, plus the success of foreign-born entrepreneurs, explains why five of the ten biggest fortunes (on Mr Beresford's numbers) belong to immigrants.

Self-made men and new arrivals may be harder to resent than those born with surnames that they share with the most expensive parts of London. And the new rich are invisible in other ways. The private-equity deals and trades in instruments like credit derivatives that have created so much wealth are not as tangible as the products of privatised utility companies. One reason the “fat cats” of the 1990s were so unpopular is that people could understand where their money came from.

The politics of wealth has also changed. Since a spendthrift Labour government was elected in 1997, worries about the gap between rich and poor have eased. The absence of a major left-wing opposition party also means there is little rich-eating rhetoric in politics. Since 1994, the national lottery has also made the idea of acquiring a small fortune quickly and easily seem normal.

Meanwhile, the salaries of top sportsmen have increased rapidly. Since 1992, when the top division in the English football league signed a deal with Sky, a broadcaster, the clubs' wage bills have increased by 17% a year, according to Stefan Szymanski, an economist at Imperial College in London. This has helped to uphold the notion that people who excel at what they do deserve to be paid much more than those who are merely mediocre. And, conversely, that the rich must also be very good at whatever it is they do. The yuppies would be appreciated more now.

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International adoption

Like a virgin birth

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A fuss over the Material Girl and an African baby

IF THE spectacle of a middle-aged white woman dancing around an orphanage in Malawi was distressing for many Britons, the subsequent news that Madonna, a pop singer, was adopting a motherless one-year-old from the country was not much better. Baby David arrived in Britain a fully-formed celebrity child, shrouded from the paparazzi by a hooded sweatshirt, on October 17th. All being well, he will spend the next few decades jetting between houses in London, Wiltshire and America. His new mum told an interviewer for the celebrity magazine *Hello!* that David "is just the best little baby ever".

But his future is not settled yet. Children's charities in Malawi have asked judges to rule on the legality of the adoption, claiming that visitors are not allowed to adopt. In Britain, courts in two districts where Madonna owns homes are refusing to say whether she and her husband, the sometime film director Guy Ritchie, have gone through the tortuous and costly legal process deemed essential before an adoption can take place. Britain's middle-market newspapers are alternately fawning (over the baby) and appalled at his new mother, speculating gleefully that, if Mr and Mrs Ritchie have breached English law, they could be jailed.

And lo! Social services came upon them

From a public-relations point of view, baby David's new parents have two things working against them. First, although white mothers with black babies are common in Britain (the 2001 census recorded over 300,000 children with one white and one African or Afro-Caribbean parent), many social workers have long disliked the idea of white folk adopting black babies. In 1972 the American National Association of Black Social Workers insisted that families "of African ancestry" should be kept together. Soon after its British equivalent agreed, stating that "transracial placements are a way of perpetuating racist ideology". Such attitudes linger.

The second, and perhaps more serious, problem is the British dislike of queue-jumpers. As experienced by most people, adoption is a slow, grinding process. Inter-country adoption is expensive, rare and trickier since the law was tightened in 2002. Just 300 families manage it each year. The suspicion that some stars (Madonna is seeking to join Hollywood folk such as Angelina Jolie and Ewan McGregor in adopting from abroad) are sidestepping such obstacles to create their rainbow families is irksome to many. Pity David: he has toddled into a stormy debate.

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On-campus extremism

Chasing shadows

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University extremism is next on the government's hit list

ASIAN-LOOKING and Muslim students of all colours beware: the government is out to spy on you. Or so the *Guardian* newspaper said on October 16th, citing a leaked document it had obtained from the department for education. The newspaper claimed that the document was a draft of guidance for universities that advised them to inform on suspicious-looking students lest they drift into terror plots. The education department dubbed the story “inaccurate”. But later that day Ruth Kelly, the communities secretary, defended “sensible monitoring” of campus capers. And the leak has reignited a debate about how universities ought to tackle extremism and how much of a problem it is.

The leading academic proponent of a crackdown is Anthony Glees, an expert in security studies at Brunel University. Last year he named 13 young Muslims who had both studied at British universities and allegedly been involved in terrorist plots. He also identified 21 institutions where there seemed to be evidence of Islamist activity. Since then, the head of a student Islamic society has been charged with planning to smuggle explosives on board a plane bound for America. Mr Glees reckons universities are especially vulnerable to infiltration because of the value they place on free speech.

Some other academics share his concerns. Tom Gallagher, who studies ethnic conflict at Bradford University, says that the government's drive to increase the proportion of young people at university to 50% by 2010 has led to poorly educated Muslim students pitching up at universities. Some, confused and struggling, become easy targets for demagogues who enable them to make sense of their lives. Mohammed Sajid, also of Bradford University, says some Muslim students dislike the hedonism of campus life, so gravitate towards Islamic societies—and “all sorts of things go on in those groups”.

Yet Universities UK, which represents Britain's colleges, is furious. It calls the leaked guidance “unreasonable” and “counter-productive”. The National Union of Students accuses the government of fomenting “McCarthy-like suspicion between students and lecturers”.

The imam at London Metropolitan University, Musa Admani, concedes that some students hold extreme views. But he says they are fewer—or, at least, quieter—than in the late 1990s, when Islamic society meetings threatened to lapse into violence. Mr Admani also distinguishes between dangerous extremism and noisy radicalism. More hold radical views about British foreign policy these days, he says, but most eschew violence. Some support for that view comes from a survey of Muslim students carried out after the London bombings in July 2005, which found that just 4% refused to condemn the attack.

Student apathy and silliness may be a potent weapon against violent extremism. Akil Awan, an expert on radicalisation at Royal Holloway College, says that, of the groups he interviewed, students were the least articulate and the most impressionable. “They dally with different views and can't remember what they said from one week to the next,” he says.

The biggest problem with suppressing agitation on campus is practical: extremism reacts to scrutiny by moving on. Before the atrocities of September 2001, some British mosques were recruiting grounds. But no serious plotter would now lay plans at a mosque. Islamists believe (often falsely) that places of worship are under intensive police and security-service scrutiny. If they suspect that universities, too, are full of spooks they will decamp. That would be good news for universities, but not for the struggle against terrorism.

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Halal food

The crescent and the canteen

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How an influx of Muslims is changing university diets

VASILIS ANASTASIOU has sold halal meat from his Cambridge kebab shop for the past 18 years. As his name hints, this is not out of personal religious conviction. “I am Christian Orthodox, but if I can sell food which makes everyone happy, why not?” he asks. Mr Anastasiou pays a premium of about 5% for halal meat. In return, he picks up custom from Muslim students whose dietary requirements are not catered for in college, and is occasionally asked to host meetings of the university Islamic society.

Entrepreneurs are good at satisfying niche appetites, large institutions often less so. But British universities are changing. Last November students at Leicester University persuaded their union cafeteria to ban pork and go exclusively halal. Sheffield Hallam University now boasts an on-campus branch of Hally Ally's, a halal fast-food outfit. Two further branches of the chain are expected to follow in other northern universities by the end of the year.

Masood Khawaja, president of the Halal Food Authority, has spent six months scrutinising campus kitchens. He plans to assess university caterers in the same way that his organisation judges supermarkets and slaughterhouses. That ought to be an improvement on the hit-and-miss experiments of the past. Sheffield served halal dishes in its main canteen for years before realising Muslim students mistrusted the purity of the meat, which sat alongside forbidden foods. These days, by contrast, college caterers tend to phone ahead to check if they may cook food in certain oils or pans.

The changing menus partly reflect a growth in the numbers of Muslim students. Last year, 8,450 British Pakistani students entered university—up from 4,040 ten years ago. The number of Bangladeshis, another overwhelmingly Muslim group, roughly trebled over the same period.

What of non-Muslim students' tastes? “You don't have to be a vegetarian to enjoy the food in a vegetarian restaurant,” argues Nick Robinson, Leicester's catering manager. Not everyone agrees. At Oxford University, where an almighty animal-rights rumpus is already under way over a new laboratory, some chefs have objected to preparing halal meat because of the way it is slaughtered. The university's secular society has also protested.

In the end, financial imperatives are likely to erode such concerns. Some of the most observant Muslim students come from Asia and the Middle East, and they are worth three times as much to most universities as British students. Sheffield Hallam recently hosted a summer school for 513 Malaysian students, many of them Muslims. If halal kebabs help to persuade some to enroll for further courses, each will bring the university some £9,000 ($16,800) a year in fees. A mouthwatering prospect.

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Water companies

Leaky

Oct 19th 2006
From The Economist print edition

Water is not as risk-free an investment as it looks

DESPITE being something that falls from the sky, water is suddenly in demand in the City. Several of Britain's water firms, including Anglian and Severn Trent, have been in the news as possible or actual takeover targets. The biggest is Thames Water, which serves 13m customers in and around London and has been the subject of a bidding war for several weeks. The contest finished on October 17th when RWE, Thames's German owner, announced that a group led by the Australian bank Macquarie had won with an offer of £8 billion (including debt), trumping even the petrodollar-financed Qatar Investment Authority. A meeting of RWE's supervisory board over the weekend is expected to approve the deal; if that happens, everything should be finalised by December.

Water mania is one symptom of a broader fad for utilities. Investors are seeking boring industries with predictable rates of return to balance their portfolios of chancier investments. Government bonds traditionally met that need, but yields are low and investors are looking elsewhere. Water companies are especially attractive: they are the monopoly providers of an essential service for which there is no substitute, and Ofwat, the industry's regulator, allows them to earn an attractive rate of return. The sale will cause smiles at RWE, which paid £6.8 billion for Thames in 2000 but now plans to retire from the water business to spend more time with the gas and electricity markets. It said it expected to bank “hundreds of millions of euros” from the deal.

Reactions elsewhere were more mixed. Lakis Athanasiou, an analyst at Collins Stewart, thinks the firm is dear at the price; Lueder Schumacher, of Dresdner Kleinwort, believes it to be roughly in line with other utility deals. Even Ofwat seemed cautious: on October 16th, before the bids were finalised, it warned firms against overpaying and reminded them that the current regulatory regime was no guide to a future one.

But never mind the financial rune-castings: Thames Water is operationally risky, too. The firm's miles of Victorian pipes are so decrepit that almost a third of the water that flows through them seeps into the ground. Despite receiving more lenient treatment from Ofwat than its competitors, it has missed leakage targets for the past three years, prompting the regulator to force it to invest £150m in June. At the same time water bills have risen and so have profits, which were up by a third last year to £347m, prompting accusations that Ofwat has been too lenient.

With London's population forecast to grow even as the skies dry up, Thames Water will have to build lots more infrastructure. A proposed new sewer under the river Thames is predicted to cost around £2.5 billion; a planned new desalination plant £200m; and a new reservoir in Oxfordshire £1 billion. All these estimates are preliminary, and big engineering projects have a tendency to bloat. Ofwat assumes that firms will manage such projects efficiently, says Philip Fletcher, its boss: “It's not for the customer to bail out an owner that's not been doing its job properly.” An engineering slip-up could turn a nice little earner into an albatross overnight.

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School leadership

Fewer chiefs, more Indians

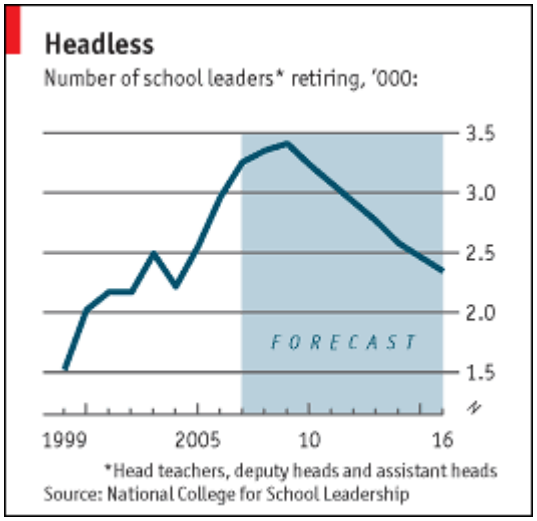
Oct 19th 2006 | CAMBRIDGE
From The Economist print edition

Using scarce head teachers more wisely

ON THE face of it, Newnham Croft Primary School is a blessed spot. Situated in a village just outside Cambridge, next to Grantchester Meadows (immortalised by Rupert Brooke and Pink Floyd), it is small, pretty and full of the children of education-obsessed academics. But when the headmistress left teaching last Christmas, the governors were unable to replace her. In the end the local council asked Roger Marcon, an educational consultant, to step in temporarily.

Newnham Croft faces particular difficulties. As a small primary school, it cannot pay a head teacher much—and family houses nearby cost upwards of £500,000. Cambridge schools are hard on heads—those pesky academic parents think they could do the job themselves, only better. But schools all over the country are in the same boat. According to the National Association of Head Teachers, around 1,200 British schools are currently making do with temporary heads. That makes it difficult for the weaker ones to improve: as a parliamentary committee reported on October 17th, heads are vital to turning around failing schools.

Heads tend to be appointed in their mid-40s after 15-odd years in the classroom and another five or so as a deputy. They increasingly retire, exhausted, at just 55, which means the loss of baby-boomers is already being felt. The National College for School Leadership, which trains head teachers, predicts that retirements will not peak until 2009 (see chart).



Compounding the demographic problem, potential heads are sitting on their hands. A survey by the General Teaching Council in September found that deputies are looking at their boss's job and vowing never to apply for it.

“Far too much time is spent reacting to bureaucratic initiatives,” complains Mr Marcon. Heads are accountable to everybody, he says. And politicians believe that every problem in society, from religious and racial segregation to obesity and laziness, has a solution involving schools. Many head teachers are excellent managers, but they are too swamped to offer strategic leadership. In order for headship to become attractive again, Mr Marcon thinks the role itself must change.

To glimpse one possible future, look at Parkside Community College, a popular secondary school in central Cambridge that takes most of the 12-year-olds who leave Newnham Croft. In the summer of 2005, Parkside federated with Coleridge Community College, a failing neighbour under threat of closure. Applications and results at Coleridge are already rising fast.

“It was a takeover,” says Andrew Hutchinson, formerly the head of Parkside and now the federation's executive principal. He says the merger brought to Coleridge—a school where “the brand didn't work”—the systems and ethos that made Parkside so successful. A vice-principal and four deputy heads (two for each school) now answer to Mr Hutchinson. Such a set-up is an elegant way of coping with a national shortage at the top: one head and five deputies are easier to find than two of each.

The boss's role has changed, too. “I couldn't do the same as before, but twice over,” says Mr Hutchinson. He now delegates more, to his deputies and departmental heads—some of whom may, as a result, find they have a taste for leadership. It also makes his job more manageable, as he can concentrate on

leading. Perhaps recruiting traditional head teachers has been difficult, not because the job is too large, but because it is too small.

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Politics and the army

Trouble in the ranks

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A breach between the generals and the politicians

TONY BLAIR rarely seems happier than in the company of the British soldiers he has sent into so many operations, from Sierra Leone to Iraq and Afghanistan. But the troops have become troublesome, even rebellious, of late. In remarks published in the *Daily Mail* on October 13th, General Sir Richard Dannatt, the head of the army, offered the gloomiest assessment of the war in Iraq to be uttered publicly by a senior officer.

The army is under strain. About a fifth of its men are deployed on operations, including 5,600 in Afghanistan, 7,200 in Iraq and 8,500 in Northern Ireland. Squaddies are complaining about shortages of equipment, the lack of military hospitals and the effectiveness of ground support provided by the air force in Afghanistan. Soldiers' grainy video footage of ferocious battles, smuggled out of the country, has dramatised their grievances.

Sir Richard's challenge was more fundamental. He suggested the government risked breaking the “covenant” between the nation and the armed forces: soldiers endanger their lives for their country, but expect respect and decent conditions of service in return. Sir Richard questioned the attempt to impose democracy in Iraq and argued British forces should leave “sometime soon” because their presence was worsening the security situation.

In a subsequent radio interview he explained this applied only to some parts of the country. Yet his message was unchanged: a prolonged deployment in Iraq at current levels could “break” the army. Sir Richard appeared to favour an early departure from the country to focus on Afghanistan, where overstretched British and other NATO forces have been wounded by a resurgent Taliban since deploying to southern provinces in July.

Precious combat troops in Afghanistan have been tied up defending isolated outposts in southern Helmand province. In one exposed position in Musa Qala, a local ceasefire has been arranged with tribal elders. This week British forces agreed to hand over control to a force of “auxiliary police” of dubious loyalty.

Sir Richard was rebuked by politicians of all stripes (including some former defence secretaries) for breaching the convention that prevents soldiers from openly questioning government policy. Yet the prime minister chose not to escalate the dispute. He professed to agree with every word the general had spoken on the radio, but said British forces would stay in Iraq “until the job is done”. He added that he could see the Iraqi security forces taking on much greater responsibilities in 12 to 18 months.

Given the level of inchoate discontent in the ranks, Mr Blair was probably wise. With no formal organisation to represent their interests many soldiers feel their commanders' private representations to ministers are no longer enough. Although some senior colleagues think Sir Richard too emotional and question the wisdom of a hasty pull-out from Iraq, he won praise from all ranks for standing up to the government. “It's good to see we finally have a member of the top brass with some balls to match,” says one contributor to Army Rumour Service, a website closely watched by commanders.

Returning home this week, Brigadier Ed Butler recounted how erratic supplies reduced soldiers to emergency rations as they struggled to stop the Taliban. Unless things improve, soldiers may not give Mr Blair such a warm embrace the next time he visits them in the field.

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Taxation

Taxing for the Tories

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Tax advice that will fall on deaf ears

IT IS a measure of how keen the new Tory leadership is to escape the party's recent past that the report of its Tax Reform Commission, published on October 19th, looks like the work of an independent think-tank. The only hint in the 176-page document that it might have something to do with the Conservative Party is an admission in the foreword by the commission's chairman that it was set up at the behest of George Osborne, the shadow chancellor.

There are two reasons for this shyness. The first is that there is still a reluctance to attach the Conservative “brand” to anything for fear of sullying perfectly decent ideas. The second is embarrassment that an “independent” commission has come up with a list of 40 proposals that together would cut taxes by at least £21 billion a year. This is not the current party line.

Since becoming leader last December, David Cameron has systematically jettisoned any policy believed to be responsible for the Tories' election-losing streak. Mr Cameron knows that Gordon Brown, the chancellor and prime minister-in-waiting, will turn any Conservative hint of lower taxes into terrifying images of lengthening hospital waiting lists, overflowing classrooms and soaring mortgage rates.

That fear has persuaded Mr Cameron and Mr Osborne to repeat the mantra that economic stability must come before lower taxes. Their only concession is to promise, vaguely, that the “proceeds of growth” will in time be shared between spending and cuts.

Such nervousness is understandable, but it may also be misplaced. There is ample evidence that Britain's tax burden has been growing at a worrying rate. According to an OECD report last week, Britain has the fastest-growing tax burden in Europe except for Iceland, and has recently overtaken Germany. As the tax commission points out, Britain is going in the opposite direction to some of its competitors: in 2007 tax in Britain is expected to reach 42.6% of GDP while the OECD average will have fallen to 37.9%. Corporation tax in Britain now looks particularly onerous compared with some other countries. Even Mr Brown was forced to acknowledge that fact in a meeting with City bigwigs this week.

The commission makes a powerful case for less complexity, less tinkering and better legislative scrutiny of the tax system. It even dares to suggest that a lower-tax economy might grow faster and generate more tax revenues over time. It would be a shame if the Tories renounced their tax-cutting instincts at precisely the wrong moment.

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Bagehot

The uncomfortable politics of identity

Oct 19th 2006
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Multiculturalism may be dead, but it's not clear what will replace it

TONY BLAIR this week confirmed what has become ever more apparent in the fortnight since Jack Straw lit the blue touch-paper with his comments on the wearing of the veil by Muslim women. The government now believes that Britain has struck the wrong balance between the tolerance of cultural diversity and the need for minority communities to integrate with wider society.

Asked at his monthly press conference whether he agreed with the suspension of a Muslim woman assistant teacher in the Yorkshire town of Dewsbury for refusing to remove her veil at school, Mr Blair said that he “fully supported” it and that he believed the veil was a “mark of separation”. It was time, said Mr Blair, for these issues to be properly debated.

Thanks to Mr Straw that is certainly happening. The former foreign secretary and now leader of the House of Commons is the MP for Blackburn, an old mill-town in the north-west with a large Muslim population of mostly Pakistani origin. Earlier this year he treated his friend and American opposite number, secretary of state Condoleezza Rice, to a tour of the town. Ms Rice was reportedly astounded by the lack of integration she found there.

As one of Britain's canniest political operators, Mr Straw knew he would create a stir in revealing he had asked constituents wearing the *niqab* to remove the veil from their faces when meeting him and that he regarded it as a barrier to good community relations. But even he has been surprised by the reaction.

For two weeks, the airwaves and the newspapers have been dominated by what it is fashionable to call the politics of identity. There is still no sign of the debate flagging. Indeed, the government seems to be doing everything it can to keep it going. Last week Ruth Kelly, the communities secretary, announced that the government was undertaking a “fundamental rebalancing” of its relationships with Muslim organisations and that funding would shift towards those which actively tackled extremism and defended “our shared values”.

Ms Kelly was reflecting growing government disillusionment with the Muslim Council of Britain (MCB), an umbrella body that claims to speak for Britain's 1.6m Muslims. Ms Kelly, a devout Catholic, took particular exception to the MCB's refusal to join in the commemorations of Holocaust Memorial Day. She

also criticised both its insistence that British foreign policy was anti-Muslim and its routine denigration of police anti-terrorism operations.

Meanwhile, as minister after minister has weighed in on the subject of veil-wearing, there has been wide coverage this week of government plans to open up a quarter of the places in newly established "faith" schools to non-adherents—a measure some see as aimed primarily at Muslim schools that are now eligible for state funding. In another sign of the times, an education department document, leaked to the *Guardian* newspaper, warned that universities had become fertile recruiting grounds for extreme Islamic groups and proposed that academic staff should keep a close eye on their Muslim students (see article).

The trigger for much of this is not the London bombings carried out by British-born Muslims on July 7th last year, shocking though they were, but an allegedly much more extensive plot to blow up airliners flying to America that was foiled in August. Since then, the security services have reached alarming conclusions about the number of young British Muslims who have been radicalised and their potential to become terrorists. Increasingly, ministers believe that the willingness of successive governments to tolerate and, in some ways, encourage the separateness of Muslim communities in the name of multiculturalism has been a colossal error.

The result is that the government has started to ask itself some profound questions. How far is a liberal society obliged to go in defending attitudes and behaviour that are hostile to it? Is it reasonable to demand that members of all minority communities integrate, at least to some degree, with the majority?

This has traditionally been difficult territory for many on the left. Partly it is lingering colonial guilt, but mainly it is because the left is uneasy with notions that appear to claim superiority for majority cultural norms or which confuse the duties of citizenship with loyalty to the symbols of nationalism. In the search for a fairer society, the concept of national identity seemed either irrelevant or unhelpful.

Those sentiments still exist within the Labour Party, but they are in retreat. As John Denham, the Labour chairman of the home affairs select committee, recently put it: "A society with a weak sense of any cohesive identity will necessarily find it more difficult to organise and sustain the collective responses that are needed not just to tackle disadvantage, but the welfare state, crime and security issues that dominate today's political agenda." Or, as the author Salman Rushdie observed: "No society, no matter how tolerant, can expect to thrive if its citizens don't prize what their citizenship means."

An idea of Britain

Ms Kelly has made a stab at defining "non-negotiable" British values—respect for the law, freedom of speech, equality of opportunity, respect for others and responsibility towards others—that every citizen must sign up to. Steps are also under way to introduce an inclusive, narrative account of British history to be taught in schools as part of compulsory citizenship classes.

Both are doubtless worthwhile. But it may be beyond the exhortations of worried, well-meaning politicians to revive an idea of British national citizenship that is relevant and powerful enough to do what is needed. Unless Mr Blair's debate takes place where it matters most, within the Muslim communities themselves, it is likely only to deepen existing prejudices.

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Nuclear-weapons proliferation

Going critical, defying the world

Oct 19th 2006
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A big-power stand against North Korea and Iran? Or rivalry as usual?

Get article background

IT TOOK quite literally a bomb to shift the big powers into concerted action at the United Nations Security Council against a long-defiant, boastfully nuclear-capable North Korea. What will it take for Europe, America, Russia and China to agree on the sort of sanctions that might oblige a nose-thumbing but not yet nuclear-armed Iran to obey the council's demand to stop enriching uranium and messing with plutonium, from which its own future bombs could be made?

North Korea and Iran, past partners in missile roguery, seem bent on testing the world's anti-nuclear rules to destruction. Iran refuses to condemn North Korea's nuclear test on October 9th, even though it claims its own long-secret nuclear programme is peaceful. Whether the Nuclear Non–Proliferation Treaty (NPT) survives this combined assault depends on how the big powers rise to the challenge: by co-operating to press both regimes to abandon their nuclear exploits and uphold the rules, or by competing in the wider struggle for regional influence.

On October 14th the Security Council came together unanimously behind resolution 1718, calling on governments around the world to clamp down on North Korea's trade in missiles and weapons of mass destruction. It also banned imports of some weapons and the luxury goods—from fine wines to Rolex watches—that North Korea's dictator, Kim Jong Il, relies on to buy loyalty. Iran is not the only one watching closely what happens next.

America's secretary of state, Condoleezza Rice, is on a spine-stiffening trip to Japan, South Korea, China and Russia. Although he will not attempt to dislodge Mr Kim's odious regime by force, President George Bush says that America will live up to its treaty obligations to defend Japan and South Korea, if Mr Kim makes good on his latest threat to lash out with a “merciless strike”. Ms Rice will also be encouraging her hosts to install radiation-detection devices at border crossings, ports and airports that handle North Korean goods, to ensure Mr Kim cannot peddle his bombs to others.

China is comfortable thus far. It has no wish to see Japan or South Korea frightened into going nuclear too. But North Korea may test the credibility of America's deterrence pledge. Amid signs that it is preparing a second test—whether because the first one fizzled (its yield was puzzlingly small, at less than

a kiloton) or out of pique—it calls the new sanctions a “declaration of war”.

This missile-rattling could make harder Ms Rice's second task: to win agreement from the neighbours on a sanctions regime “unlike anything [North Korea has] faced before”. Japan has banned North Korean ships from its ports and halted trade and financial flows; it is considering how it might help America do more. But China wants to avoid an economic collapse in North Korea. At its insistence, resolution 1718 authorises governments to inspect goods—as China is apparently doing at some land crossings—but it does not oblige them to do so. Nor does it authorise boarding ships on the high seas; China feared this would enable America to throw its weight about too much.

Having long insisted that the North Korean nuclear issue was better handled outside the UN, China is livid that Mr Kim brushed aside repeated warnings not to test. But if the Chinese are now ready to work through the Security Council, that is chiefly in the hope of forestalling unilateral American action. That still leaves room for dispute that Mr Kim will do his best to widen.

His nuclear antics have also upset South Korea's president, Roh Moo-hyun, whose “sunshine” policy towards the North is in tatters. Mr Roh's government is ceasing to subsidise one money-spinning project that put cash in Mr Kim's pocket, a tourist enclave at Mount Kumgang. It will continue to help an industrial park at Kaesong. Mr Roh has also cut humanitarian assistance to ordinary North Koreans.

Ms Rice is keen not to sharpen tensions (ship-boardings will apparently be few). But America is determined that Mr Kim will pay a high price. Traditional sanctions have their limits (see article). But resolution 1718 gives new backing to the American-led Proliferation Security Initiative, a posse of like-minded countries that share intelligence and intercept cargoes of suspected proliferators. It also helps America's case for a new breed of financial sanctions, which over the past year have encouraged a number of banks and businesses around the world to shun North Korean companies that launder ill-gotten gains, including from missile sales.

North Korea is dangerous, but isolated. An Iran with nuclear weapons, says one senior Bush administration official, would be a “game-changer”. The virulence of the regime's revolutionary ardour, its role as “central banker of terrorism” to organisations like Hamas and Hizbullah that preach and practise violence against Israel, and its ambition for dominance in the region and the Islamic world, all make it imperative, from the West's viewpoint, to stop Iran before it gets a bomb. The sight of a nuclear-armed Shia Iran would probably encourage Sunni regimes in Saudi Arabia, Egypt and elsewhere to want their own finger on a nuclear trigger.

Prepare for a wrist-slapping

Reason enough for the Europeans, Americans, Russians and Chinese to press Iran to come clean sooner rather than later about its nuclear past and halt its dubious uranium and plutonium activities? Indeed, all have backed a package of incentives that include helping Iran to benefit from peaceful nuclear energy—a big policy shift for the Bush administration, which has also said it would join negotiations with Iran. But Iran's answer is a raspberry.

Despite that, the first sanctions to emerge from the discussion now getting under way at the Security Council will be feeble. Russia wants to exclude its Bushehr nuclear reactor project in Iran (though it has repeatedly delayed providing the start-up fuel); it also sells Iran lots of weapons. The country is an important neighbour, and offers Russia one of few ways back into Middle East diplomacy. In any case, Russia points out, Europeans and others trade with Iran too.

Sanctions are supposed to become steadily tougher if Iran carries on enriching. By moving slowly, the Europeans, Americans, Russians and Chinese have managed to stay in step. But Iran, perched on a cushion of high oil revenues, is betting on staring them out, all the while perfecting its enriching skills.

It helps Iran that, just as the world gears up to enforce the anti-nuclear rules, the rules may be changing. Iranian officials point to India, a country that built nuclear weapons outside the NPT, and yet is now accepted by America, which recognises it as a “de facto” nuclear power (and is attempting to rewrite the rules accordingly), in hopes of making it a “strategic partner” in Asia. If India can have any technology it wants, Iran asks, why not us?

The spread of weapons of mass destruction is a clear threat to international peace and security. It remains to be seen whether tackling proliferation is something the world's big powers are ready to put

ahead of their own rivalries.

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Sanctions

History lessons

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Blunt instruments make for botched jobs and unbothered dictators

INSTEAD of worrying about sanctions, Kim Jong Il might gleefully consider the fate of Athens 2,400 years ago. It decreed a trade embargo on neighbouring Megara, but the ensuing 27-year struggle left the Athenians humiliated and Megara's ally, Corinth, triumphant.

That may be the first instance of sanctions failing, but there are plenty of more recent cases. In the 20th century they were used ever more often, especially by American presidents and lawmakers. Franklin Roosevelt tried sanctions on Japan in 1940. Dwight Eisenhower smacked them on Britain in 1956 to end the Suez venture. Jimmy Carter punished the Soviet Union after its invasion of Afghanistan in 1980 with a wheat embargo and an Olympic boycott. Ronald Reagan imposed them in protest at martial law in Poland. Congress, too, came to see sanctions as an easy, cheap way of expressing ire. In 1996, for example, Belize, Colombia, Costa Rica, Italy, Japan, Mexico, Panama, Vanuatu and Venezuela were all under American embargo for beastliness to whales or dolphins. In the next five years America imposed 85 new sanctions on foreign states.

Sanctions may feel better than nothing: they are less feeble than scolding an ambassador and less bloody than sending in the marines. They provide a frisson of moral satisfaction. And sometimes they work—ending Britain's Suez foray, for example. The threat of penalties by city and state officials in America in 1998 forced a group of Swiss banks to cough up $1.25 billion for some Holocaust survivors. Libya's return to respectability may have owed something to sanctions. They played a part in ending white rule in South Africa too.

Spotting the failures is easier. The League of Nations' sanctions did not protect Abyssinia against fascist Italy. The United Nations did no better with Saddam Hussein's Iraq. Harsh regimes are still in place in Iran (under American embargo since 1979), Myanmar (since 1997), Sudan (since 1996), never mind Cuba (1962).

Regime change may not be sanctions' aim; behaviour change may suffice. Even so, snags abound. The morality of punishing poor people who live in a boycotted autocracy is dubious. It may make the regime more popular or powerful. Mr Hussein easily ensured that sanctions hurt chiefly the innocent. Scarcity provides an excuse for rationing, permits and licences, creating corruption, favouritism and a black market which the regime can control. In Slobodan Milosevic's Yugoslavia, sanctions virtually fused the state with the criminal class.

Sanctions may have other results too. Arms embargoes turned South Africa into a huge maker, then exporter, of guns, and may have encouraged Pakistan to go nuclear. They hurt the Serbs and Croats much less than the Bosnian Muslims the West hoped to help. In Haiti the misery they caused in the early 1990s washed thousands of refugees up on America's coast.

Floridians' complaints were added to the more familiar ones of American farmers and businessmen, whose markets shrink with every wheat embargo or investment boycott. Sanctions in 1995 alone cost American firms between $15 billion and $19 billion, and they affected some 200,000 workers. Impex, a Japanese firm, this month blamed American-inspired sanctions for its loss of a leading role in developing an oilfield in Iran. No wonder that sanctions, especially unilaterally imposed ones like America's ban on trade with Cuba, cause friction among allies.

Not that sanctions are necessarily futile. They may have some value simply in expressing condemnation. But they work best when clearly defined and with an achievable end. If that is not achieved, as in 1990 when the UN ordered Iraq, in vain, to withdraw from Kuwait, then it can at least be argued that using

force is justified.

It helps, too, if a mechanism for ending sanctions is made clear at the outset; they are easier to impose than to lift, and the sanctioned regime is unlikely to make even small concessions if these are not greeted with some easing of the boycott. Moreover, after years of ritual blacklisting, fatigue sets in among the boycotters.

If they are to work, sanctions must be imposed by as many countries as possible. The rebellion led by Ian Smith in Rhodesia in 1965, which Harold Wilson, Britain's prime minister, expected sanctions to end within “weeks rather than months”, was sustained by neighbouring South Africa for 14 years. North Korea's survival will be similarly affected by how China behaves.

The fashion now is for “smart” sanctions, which try to isolate and hurt the regime and its cronies, not the innocent. But the people sanctioned must mind. Robert Mugabe's wife may no longer be able to go on the shopping trips to Paris that she used to enjoy; her husband seems unworried. On the other hand, Swiss bankers do want respectability. Apartheid South Africa did want to count as a democracy, and it hated its exclusion from world sport. In short: sanctions work best when aimed at hypocrites. Mr Kim, for all his faults, may see no merit in vice paying any homage to virtue.

One other problem arises from the new urge to isolate odious leaders. Such people already tend to be remote from reality. They are surrounded by yes-men and often ignorant of other countries. Increasing their isolation may be dangerous.

It is not far-fetched to argue that most of the nastiest wars of the 20th century could have been averted had the aggressor known what would follow. If part of the blame for the two world wars, and the Korean, Falklands and first Gulf wars, lay with the failure of others to convey the appropriate message, part also lay with the isolation and ignorance on which the aggressors based their misjudgments.

Arguably, Mr Kim should be brought closer to reality, not driven deeper into the realms of ghastly fantasy. History holds lessons for the sanctioner as well as the sanctioned.

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Islam and the Vatican

An invitation to talk business

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For the big monotheistic faiths, holding a debate looks hard but necessary

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DO THE leaders of the Muslim and Roman Catholic faiths—accounting, at least on paper, for over one billion people each—have any clear ideas about how to deal with one another? That's a question followers of both creeds have been asking as controversy about a speech by Pope Benedict continues to claim lives. A priest in Iraq was found beheaded last week, even though his parishioners had yielded to the captors' demand that they renounce the pope's words on Islam.

On the Muslim side, there have been significant moves in recent days. Some 38 of Islam's most senior figures—including the grand muftis of Egypt, Oman, Bosnia, Syria and Russia and scholars from all the religion's main schools—have addressed a careful, elaborate message to Benedict XVI, in the apparent hope of taking Catholic-Muslim encounter away from the streets and into the debating chamber.

Reuters

Give me a nice knock-down argument

The letter challenges the pontiff to engage in the thing he says he wants most: a robust, courteous exchange about faith and reason. The signatories said they appreciated the pope's expressions of sorrow over the reaction to his address in Germany last month—in which he mentioned (without endorsing) a medieval claim that Islam brought nothing new but violence.

But they also take the pontiff to task on lots of things. The pope had implied, for example, that Muslims believed in a deity so far beyond all categories—such as goodness or rationality—that God could as easily be cruel and irrational as merciful or peaceloving. Not so, the greybeards shot back: there is only one obscure Muslim thinker (a certain Ibn Hazm) who ever said anything like that, and to dredge him up is to paint Islam in an unfair light.

Another point: the pope appeared to downgrade one of the Koran's best-loved statements—“there is no compulsion in religion”—by saying it belonged to the earlier, emollient phase of the Prophet's life as opposed to the latter part, when there was more emphasis on politics and the rules of war. But on that, the scholars said, the pope is just wrong: the “no compulsion” verse is late, not early.

How much hope do the scholars have of moving their encounters with the Catholics back to the safety of academia? In Egypt, the letter drew a cool response from leaders of the worldwide Muslim Brotherhood: how can we accept the pope's apology when he hasn't apologised, merely expressed regret? To which the signatories replied, “Let's at least give him credit for going as far as he did.”

Vatican officials have cautiously welcomed the scholars' letter, saying they too see prospects for a tough, meaningful conversation. After all, they point out, the pope has often said that the two faiths have different, but related problems: for the Christian, today's adversary is “reason without faith” or cold secularism. For moderate Muslims, it is “faith without reason” or violent fundamentalism.

The same officials also insist that the German lecture was not a deliberate provocation. But many Vatican-watchers feel that in his assessments of the Muslim scene, the current pope is more inclined than his predecessor, John Paul II, to be pessimistic. That is partly because of Benedict's personal history: in

his previous job as chief enforcer of Catholic teaching, he voiced exasperation with doctrinal innovators who—in his view—tried to water down their Christianity with “eastern” religions, including Islam.

Another factor is the increased profile in the papal entourage of Arab Christians whose view of Islam is influenced by their own experience of inter-religious tensions in their homelands. In 2005, a few months after his election, Benedict presided at a meeting of his former doctoral students at which the topic was Islam. One of the two outsiders invited to the discussions was an Arab Jesuit with uncompromising views. The meeting is understood to have ended with broad agreement that there is little scope for discussing the basics of theology with Muslims: as a religion that puts overwhelming stress on revelation, its tenets are fixed and not open to re-interpretation. So (on this controversial view) it would be more worthwhile for the two faiths to discuss practicalities, like curbing violence and ensuring religious freedom.

If that view prevails, it will be a disappointment to some of the scholars who wrote to the pope. As many authorities on Islam would point out, Muslim thinkers were arguing hard over the boundary between faith and reason 1,000 years ago—and there are Muslims today who want to revive the “rationalist” side of that argument. Without interfering, the pope could help by indicating he does not see all Muslims as unreasonable types.

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Options backdating

Walking the plank

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More chief executives lose their jobs amid America's options-backdating scandal

THE toll has now reached 34 top executives and directors, and counting, including no fewer than six chief executives in the past week. Corporate America has never seen anything quite like the carnage caused by the scandal over the backdating of employee share options. Over 100 companies are known to be under investigation for allegedly backdating options to value them at low points in their share prices, and several hundred more have come under suspicion.

On October 15th came the most significant departure so far. William McGuire, the boss of UnitedHealth Group—a health insurer with a stockmarket value of $63.4 billion—agreed to leave after a report to the board by a law firm concluded that he had benefited from backdated options and criticised him for apparently failing to disclose conflicts of interest arising from his financial dealings with William Spears, the chairman of UnitedHealth's compensation committee. This cloud has a silver lining for Mr McGuire, however: depending on the outcome of negotiations with the firm, he could walk away with options and other benefits worth over $1 billion. That is on top of the $530m he has earned since taking the top job at UnitedHealth in 1992.

Others to lose their jobs in recent days because of alleged backdating include the heads of McAfee and SafeNet, two computer-security firms, CNET Networks, an internet publisher, KLA-Tencor, a semiconductor firm, and Sapient, a consultancy. Speculation remains rife about the fate of Steve Jobs, the guiding light at Apple Computer. A subcommittee of Apple's board, which included Al Gore, a former vice-president, cleared Mr Jobs of any misconduct and said that he did not benefit personally from backdating or understand its accounting implications (backdated options should have been treated as a cost). But it noted that Mr Jobs “was aware that favourable grant dates had been selected” in some instances.

Pre-emptive strikes

The backdating scandal was triggered by several academic papers that identified suspiciously favourable patterns in the timing of option grants. Ominously, “Lucky Strike”, a conference to discuss backdating on October 30th in Washington, DC, will air more academic research that raises questions about executive pay. For example, a study by Alan Jagolinzer of Stanford University has found that executives trading under SEC rule 10b5-1, which is designed to ensure they do not take advantage of insider information, has generated suspiciously high returns.

So far, only two firms—Brocade Communications Systems and Comverse Technology—have had charges related to backdating brought against their executives. That so many firms have removed top executives without any charges having been brought against them is unprecedented, and, according to some experts, the clearest proof yet that there has been a sea change in corporate governance during the past five years. Boards have come to understand that pre-emptively cleaning their own houses is likely to help in their dealings with regulators and prosecutors.

The limited action by regulators and prosecutors may also reflect the difficulty that they are having with demonstrating wrongdoing. Backdating itself is not illegal, though a lack of accurate disclosure of it may well be fraud. Moreover, backdating has become a byword for a whole series of activities, some of which seem unambiguously wrong (Comverse is alleged to have created a slush fund of options allocated to non-existent employees), but many of which may simply have resulted from negligence and disorganisation.

Some of the biggest users of share options for employees are entrepreneurial growth-oriented firms, which are often too preoccupied with trying to succeed to devote much time to internal controls and bureaucratic best practice. The report to UnitedHealth's board is a lot more convincing about the inadequacies of the firm's internal systems than it is in showing that Mr McGuire knowingly sought to benefit by backdating options or failed to disclose a conflict of interest. In the years before 2002, when backdating was common, there was a “different control environment, a different economic environment”, firms were in a battle for talent in which a juicy option package was the best recruitment tool and “people just weren't thinking all that much about the details of option accounting”, says Roman Darmer, a lawyer involved in the investigations that led to the departures at McAfee.

Given the enthusiasm with which America's trial lawyers tend to sue at the first whiff of corporate wrongdoing, there have been surprisingly few lawsuits filed over backdating so far, says Frank Graves of the Brattle Group, an economic consultancy that provides expert testimony in court. One difficulty is that courts require a paper trail, not just statistical irregularities, to be convinced that wrongdoing occurred. Another challenge is demonstrating clearly what impact, if any, backdating had on the value of a firm's shares. Because of statistical lags, uncertainty about exact dates and accounting restatements by firms as they try to record their backdated option grants, “value impacts are often a little ambiguous”, says Mr Graves.

This is underscored by the different ways in which markets have reacted to the various executive departures. Shares in McAfee jumped on news of the departure of its tainted bosses; CNET's shares dropped on its announcement. UnitedHealth's share price, which has not recovered the ground it lost when allegations were first made against Mr McGuire, slipped again on news of his departure—which is perhaps not surprising given that, whatever his wrongdoings, Mr McGuire had made his shareholders a fortune over the years by turning a small firm into a hugely successful industry leader.

All of which raises the fascinating and entirely hypothetical question of what would happen if Mr Jobs could not remain the boss at Apple, which reported a big jump in profits this week. The company's shareholders would not want to lose the man who revived their firm with products such as the iPod, says Joe Grundfest, co-head of the Rock Centre for Corporate Governance at Stanford University.

Mr Grundfest suggests the “Martha Stewart solution”. Having done time in jail for obstructing justice, Ms Stewart returned to run her firm while the roles of chairman and chief executive, with their particular legal responsibilities, were filled by others. Indeed, jokes Mr Grundfest, it is a wonder that the Martha Stewart solution—which lets the boss do the fun parts of the job while a “chief sacrificial lamb” shoulders the legal burdens—has not already become the norm.

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OPEC

Future shock

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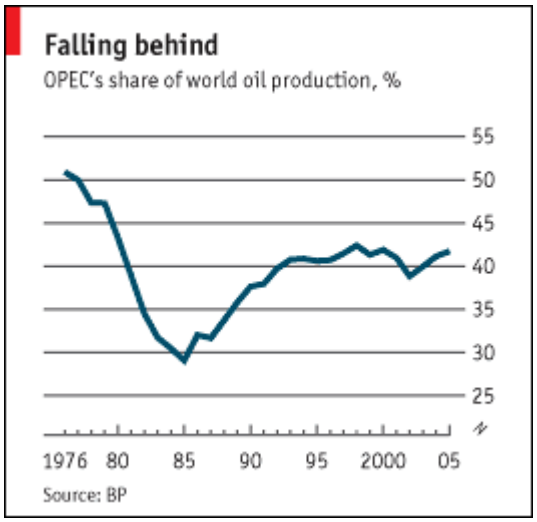
From The Economist print edition

If OPEC were a company, shareholders would be criticising its failure to invest

WHEN the Organisation of the Petroleum Exporting Countries (OPEC) meets, much of the world's population, from central bankers to lorry drivers, has a stake in how much oil the cartel will decide to pump. That was certainly so on October 19th, as OPEC's oil ministers gathered in Qatar to discuss possible output cuts. Before entering the conclave, the delegates had suggested that they might trim their collective production by 1m barrels a day (b/d)—just over 1% of global supply—but exactly how this cut would be shared and measured was still unclear as *The Economist* went to press.

Such a reduction, if deducted from actual output rather than notional quotas, and if properly implemented, should have the effect of bolstering the price of oil, which has fallen by a quarter since July. But in the long run, what matters for the price of petrol and the health of the world economy is not just how much oil OPEC's members produce, but how much they invest in future production.

Traditionally, in order to keep prices high, OPEC has reined in its own production, allowing competitors outside the cartel to expand their output at its expense. So OPEC's share of the world market has fallen from more than half in 1975 to just over 40% today (see chart). As a result, the state-owned firms that run the oil industry in OPEC countries have had little reason to invest in new production capacity.



Their output today, of some 27.5m b/d, is much the same as it was in the 1970s. What is more, they are scarred by the memory of the 1980s, when slower-than-expected growth in demand and a glut of non-OPEC supply left them saddled with lots of expensive excess capacity. The high prices of recent years are partly a legacy of that glut, insofar as OPEC, still leery of over-investment, allowed its cushion of spare capacity to dwindle to almost nothing, heightening supply concerns.

Unfortunately for oil consumers, OPEC has little incentive to expand that cushion in the short term. It would, in effect, be spending money to reduce its revenue, since the price of oil would doubtless fall if traders had no fear of future shortages. Dermot Gately, a professor of economics at New York University, has modelled OPEC countries' income at different levels of production. He concluded that any effort on OPEC's part to expand capacity to maintain its market share would only begin to yield higher revenues after 2015, and even then, the increase would be marginal. Given all the uncertainties involved, a rational OPEC planner would probably resolve simply to maintain exports at today's levels rather than add capacity.

In the past, non-OPEC firms would have more than compensated for the cartel's reticence to invest. But many analysts worry that their ability to do so is diminishing, since they are running out of territory to explore. OPEC's past inactivity, meanwhile, has left it with many promising prospects. The American government, like many others, assumes that the oil price will rise to $95 a barrel by 2030 if OPEC does not increase its output dramatically.

In theory, the fear that high prices might trigger the adoption of alternative fuels such as ethanol, or cause some other structural shift in the market, ought eventually to prompt OPEC to make the necessary investments. It says it will increase its capacity to 38m b/d by 2010. Saudi Arabia, its biggest producer, has plans to pump a third more oil.

But many projections show demand for oil growing more quickly still. Moreover, points out Amy Jaffe of Rice University, most of the OPEC countries' national oil companies have a dismal record on investment and expansion. Firms such as PDVSA in Venezuela and Pertamina in Indonesia have pledged to increase production in the past but then failed to do so. Their Iranian counterpart, NIOC, produces less oil now than it did at the time of the Islamic revolution in 1979. And OPEC's projections assume a steady increase in Iraq's output—an unlikely prospect, under today's conditions.

To make matters worse, civil strife, corruption and lack of investment are denting several OPEC countries' output. Before the meeting in Qatar, countries such as Iran, Venezuela and Nigeria argued most strongly for cuts to members' quotas because they cannot pump enough to meet their own. All of which suggests higher oil prices to come, whatever the market's reaction to OPEC's latest pronouncements.

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Gaz de France and Suez

High tension

Oct 19th 2006 | PARIS
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Is the GDF-Suez merger on the rocks?

THE odd tiff is normal with a project of such dimensions, said Gérard Mestrallet, the boss of Suez, a formerly state-owned French water and power company, in a joint interview on October 17th with Jean-François Cirelli, boss of Gaz de France (GDF), a state-controlled gas giant. After fierce clashes behind the scenes in recent weeks over the terms of their firms' planned merger—brokered by Dominique de Villepin, the prime minister, to pre-empt a hostile bid by Enel, an Italian electricity giant—the two bosses were ordered by the government to show a united front. They did, at least in public. We are, said Mr Cirelli, close to the goal.

But to most people the goal still seems far off. So far Mr Cirelli and Mr Mestrallet have not been able to agree on the finances of the deal that would create a €72 billion ($90 billion) energy giant—nor on the name, headquarters and governance of the new company. Mr Cirelli was miffed when Mr Mestrallet talked to Belgium's government about Suez's Belgian subsidiaries last week without including him. And he dislikes Mr Mestrallet's plan to sell or reduce Suez's stakes in Belgian gas companies to win approval for the merger from the European Union (EU), because it makes the merger less attractive for GDF.

Reports last week of a pact between Enel and François Pinault, a retail and luxury-goods tycoon, added to the uncertainty. Since its rebuff by the government in February, Enel has been looking for a French partner with which to launch a hostile bid for Suez. At the end of June Mr Pinault and Enel had agreed that Mr Pinault would pay some €18 billion for Suez's water and waste business if Enel were to acquire the firm. (Enel is interested only in Electrabel, Suez's electricity business.) But Enel never made its move—the state-controlled company did not get the go-ahead from Italy's new government—and Mr Pinault claims their pact expired at the end of September. He is keeping his options open, he says, as is Enel.

The potential of the Pinault/Enel plan was played down by Thierry Breton, France's finance minister, who has personally lobbied hundreds of parliamentarians to support the GDF-Suez merger. Even so, in the past six months the two firms have overcome just one of the three obstacles to the deal. A draft law to reduce the state's stake in GDF from 80% to 34%, without which the merger cannot proceed, was recently approved by the lower house of parliament. The upper house is likely to vote on the law in the next few weeks.

The merger still needs approval from the European Commission. On October 13th the two companies said that in addition to previously announced concessions they proposed to sell GDF's 25.5% stake in SPE, Belgium's second-largest electricity producer, and Suez's 57% stake in Distrigaz, a Belgian gas group. Neelie Kroes, the EU competition commissioner, will rule on the merger by November 24th at the latest.

Mr Mestrallet must also win over Suez's shareholders. They are unhappy with the one-for-one share swap through which GDF would acquire Suez, after paying a €1 special dividend to its shareholders. “The only way to make the deal happen is to increase the special dividend by at least one euro,” says Eric Lopez, an analyst at Credit Suisse, an investment bank. But every extra euro means giving up some €1.2 billion of the merged firm's value.

Mr Mestrallet is backed by Mr Breton, who has invested much political capital in the merger. Yet in the run-up to the presidential election, Mr Breton is keen to avoid the impression of yielding to pressure for more cash from Suez's private investors. The question is: how much is the government willing to pay to rescue the deal?

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German industry

RAGs or riches?

Oct 19th 2006 | FRANKFURT
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Politicians and bankers haggle over a former mining giant

WERNER MÜLLER—more politician than chief executive—is the boss of Germany's oddest conglomerate, the aptly named RAG. It is indeed a rag-bag of businesses including coal-mining, power-generation, chemicals and property. What is more, Mr Müller, a former federal economics minister, is determined, against the advice of most bankers and potential investors, to list RAG's shares on the Frankfurt stock exchange some time next year. His plan is motivated both by vanity and also by political calculations reaching deep into Germany's industrial past.

RAG, formerly Ruhrkohle AG, is the final resting-place of the Ruhr mining industry, which made Germany great. The remaining coal mines in the Ruhr and Saar are due to shut by 2018 at the latest. But they carry with them a horrible legacy of uncertain liabilities, including miners' pensions and environmental costs. The Ruhr has as many holes in it as an Allgäu Emmental cheese, so that even after mines are closed they must be monitored for years to detect subsidence and flooding.

AP

Müller mulls his options

Who pays? At the moment the liability rests with RAG's shareholders, which include the power giants E.ON and RWE and the steel giants ThyssenKrupp and Arcelor Mittal. The first three have agreed in principle to surrender their shareholdings for a token €1 ($1.25) provided all liabilities are taken off their hands. Under this model, the proceeds of the stock offering would be put in a trust fund to offset the liabilities. But Lakshmi Mittal, who recently took over Arcelor, insists his 6.5% of RAG has positive value, and might block the deal.

There are plenty of investment bankers eager to explain why the break-up value of RAG, even taking into account the liabilities, is greater than the €5.5 billion or so that might be raised by a flotation. RAG owns Degussa, a specialist chemicals company. Another chemicals company might have bought Degussa for around €10 billion; but that was before Mr Müller sold off its prize asset, its building-chemicals division, to BASF for €2.7 billion in March. RAG owns Steag, which operates power plants in Germany, Colombia and Turkey. RWE or EnBW, a smaller power company in Baden-Württemberg, would probably be eager buyers for around €3 billion, if their hands were not tied politically. RAG's real-estate division would also easily find a buyer for around €2 billion.

These are all rough estimates, of course. The point is that floating the three non-mining divisions of RAG together could sacrifice value of around €6 billion, say investment bankers. Bundling them into a stock offering is unpalatable to investors and would subject RAG's shares to the usual conglomerate discount. One investment bank has offered to sell RAG to private-equity investors and put the proceeds into a capital-market fund that would gradually pay off the mining liabilities. But “locust” private-equity firms are anathema to Mr Müller and to Hubertus Schmoldt, the boss of the IG BCE, the powerful mining and chemicals union, who is also vice-chairman of RAG's supervisory board. And there is no guarantee that such a fund would produce an adequate return.

A cosier and more German solution is to get the federal and North Rhine-Westphalia governments to shoulder the liabilities. They accept the principle but cannot agree how to split the responsibility. The federal government's plan is to put the proceeds of the stock offering, topped up with another €6.7 billion of reserves, into a trust fund to meet the liabilities as they occur, getting them off the state's books. But

if the fund's cashflow proves inadequate, the taxpayer will end up paying.

Even so, this model will probably prevail. KPMG, an accounting firm, is trying to assess the liabilities and should report to the government early next year—though a preliminary estimate is €13.5 billion. The government has also asked Susat & Partner, a consulting firm, to compare the break-up value of RAG with the likely proceeds of a stock offering.

In the end it will be a political decision, since jobs are at stake. Mr Schmoldt's union accepts that coal mining has a limited future in Germany, but a large conglomerate is thought more likely to keep people employed, and to participate in restructuring the North Rhine-Westphalian economy, than a bunch of independent firms run by private-equity investors. Moreover, as a conglomerate RAG would make it into the DAX index of the top 30 listed companies, another feather in Mr Müller's cap. According to a recent newspaper profile, the cigarillo-loving Mr Müller likes to listen to Bach as he ponders his empire.

But the cost of vanity and political expediency is high. And this is just one example of how tangled up business and politics are in Germany. TUI, a tourism and shipping conglomerate, has appealed to Hamburg's city government to save jobs there by investing in its shares. (In 2003 the city government stepped in when Beiersdorf, a cosmetics firm, was threatened by foreign takeover.) The federal government is considering stepping in to buy part of DaimlerChrysler's shareholding in EADS, the aerospace consortium that owns Airbus, to keep French influence in check and save jobs, principally in Hamburg. And Volkswagen, which is protected from foreign takeover by a special law limiting voting rights, is playing power games in the takeover battle between two truck giants, Scania of Sweden and MAN of Germany. All these cases show that Deutschland AG, the meshing of politics and big business that powered Germany's growth in the 20th century, is still holding out, in places, against cross-border capitalism and the mantra of shareholder value.

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European competition law

Chimney sweeps under fire

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From The Economist print edition

Brussels targets a quaint German monopoly

GERMANY'S chimney sweeps—hallowed as bringers of good luck, with their black top hats and coiled-wire brushes—are under attack. Last week the European Commission's directorate for the internal market revived proceedings against an antiquated German law that protects sweeps against competition.

The country's chimney sweeps enjoy a near-perfect monopoly. Germany is divided into around 8,000 districts, each ruled by its own master sweep who usually employs two more sweeps. Although this is a private enterprise, the maintenance and inspection service provided is compulsory and prices are set by the local authority: sweeps cannot stray outside their district, nor can householders change their sweep even if they loathe him. This rule cuts both ways. “There are some customers I can't stand either,” says one Frankfurt sweep.

AP

Lucky holder of a monopoly

The rationale is simple: chimney-sweeping and related gas and heating maintenance in Germany are treated as a matter of public safety. Annual or semi-annual visits are prescribed, keeping the sweeps busy all year round.

For centuries, chimney-sweeps in Europe were a wandering breed. But in 1937 the chimney-sweep law was revised by Heinrich Himmler, then the acting interior minister. His rules tied chimney sweeps to their districts and decreed that they should be German, to enable him to use sweeps as local spies.

The law was updated in 1969, leaving the local monopolies in place but opening up the profession, in theory at least, to non-Germans. But in practice few apply. Four years ago a brave Pole qualified as a master in Kaiserslautern, according to a fellow student, and this year an Italian did so in the Rhineland Palatinate. But he, like most newly qualified German masters, will spend years on a waiting list before he gets his own district.

The European Commission would like to see a competitive market in which people can choose their own sweeps, just as they choose builders or plumbers. It first opened infringement proceedings in 2003, and the German government of the time promised to change the law but failed to do so. And despite the huffing and puffing from Brussels, the government is still reluctant to dismantle its antiquated system on safety grounds. The number of deaths from carbon-monoxide poisoning in Germany is around one-tenth that in France or Belgium, claims the Frankfurt sweep. So Germans are likely to be stuck with their neighbourhood *Schornsteinfegers*—whether they can stand each other or not—for some time to come.

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Face value

Macro credit

Oct 19th 2006
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Muhammad Yunus has won the Nobel peace prize for his role in promoting financial services for the poor

AFP

FOR many of the supporters of Muhammad Yunus and the institution he created, the Grameen Bank of Bangladesh, the announcement that the two will share a Nobel peace prize is long overdue—the only surprise is that it was so long in coming. Grameen's website lists 60 awards, 27 honorary degrees, and 15 other "special honours" previously received by Mr Yunus directly, and seven received by Grameen. The selection committee said the prize was for developing what "had appeared to be an impossible idea", namely loans to people who lack collateral.

Mr Yunus has unquestionably helped create an industry that provides financial services to the poor, combining his experience of growing up in a small village with his academic background as an economist to popularise what was once just a fringe area of banking and an obscure idea about alleviating poverty. Grameen has become a sizeable institution, with 6.7m customers, most of them women and all of them poor. Grameen has, by its own reckoning, distributed $6 billion in loans, each on average less than $200. Dressed in a traditional Bangladeshi outfit made by a Grameen affiliate, the charismatic Mr Yunus, with his soft voice and warm smile, can transform the dry, grinding mechanics of banking into a bewitching story about beggars, children and empowered women, all benefiting from credit that should be a human right and could even, he says, end poverty.

Even so, loans to the poor have existed for thousands of years. The formalised system of small borrowing that Mr Yunus pushed in Bangladesh beginning in the mid-1970s was being tried in bits and pieces around the world at the same time, and earlier as well. Even in Bangladesh, where his award was warmly received as an international endorsement, there are two other equally large and innovative microfinance institutions: BRAC, which dates back to the same era as Grameen, and ASA, which came later but improved on the basic model. Yet as remarkable as these three are, to single them out is, in a sense, unfair. There are thousands of financial institutions around the world providing financial services to the very poor. It is a world of extraordinary individuals, and one that has advanced as a result of collective insights. Physics and chemistry, to cite two other Nobel categories, may be built upon the shoulders of a few giants, but microfinance needs—and has—thousands of them.

Mr Yunus and Grameen succeeded by seizing an idea, expanding quickly, proselytising and resisting the temptation to move beyond the poor. His particular approach to microfinance has not, however, been without controversy. By legend, Grameen grew out of a $27 loan Mr Yunus made in 1974 to a woman manufacturing furniture who did have credit, but at an exorbitant price. Grameen emerged soon thereafter, based on several key operational techniques: loans were made to individuals but through small groups who in effect (if not explicitly) had joint liability; the loans were for business, not

consumption; and collection was frequent, usually weekly. Interest charges were significant—the money was not aid, and a fundamental tenet of Grameen is that the poor are creditworthy—but the rates were relatively low (currently just above 20%).

This approach had virtues and limitations. Low rates and lower savings (except as a back-up for repayment) meant that in its early years, Grameen relied on capital from public and private donors—something that less charismatic or connected entrepreneurs than Mr Yunus found hard to replicate. Joint liability for loans became an increasing problem for groups when some members wanted to borrow more than others. And it was unclear whether the money received really did always go to business, rather than daily needs. A deeper question is just how helpful such tiny loans really are. Heart-warming case studies abound, but rigorous analyses are rare. The few studies that have been done suggest that small loans are beneficial, but not dramatically so. A further question is whether an approach emphasising credit really can eradicate poverty: a ridiculously ambitious goal, though one that Mr Yunus's evangelical view of the virtues of credit has perpetuated. Whether this form of lending has led to peace, the presumptive reasoning behind the award, is just as big an unanswered question.

Credit where credit's due

The classic Grameen model began to fray in the 1990s and hit a wall in 1998, when a devastating flood pushed up losses and people began missing weekly payment meetings. Mr Yunus was no doubt familiar with microfinance innovations in other countries: BRI in Indonesia had transformed itself from a wreck into a huge success by emphasising savings, not credit, and other institutions had started to abandon group lending. Grameen restructured in 2001, emphasising savings (deposits now exceed loans) and relying less on joint liability for groups.

With Grameen now thriving and the Nobel on the shelf, what will Mr Yunus do next? There are persistent rumours that he might enter politics, given his prestige within Bangladesh. And this could be a good time for him to step away from microfinance, which appears to be at an inflection point. Institutions continue to emerge and grow, many funded by private capital and seeking a real return, an approach Mr Yunus opposes. They often begin by charging higher rates than Mr Yunus considers legitimate, but cut prices when their returns draw competitors—a tough but theoretically more supple model. Microfinance would also benefit from a voluntary regulatory structure to improve its access to capital, and greater use of technology to reduce transaction costs. What it needs, in short, are the boring, quiet innovations that dynamic industries depend upon, but which, alas, do not win prizes. The Nobel, and its recognition of microfinance's most charismatic cheerleader, may mark the end of an era as a more mature industry starts to emerge.

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Asia and the world economy

The alternative engine

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AFP

A sharp slowdown in the American economy could be offset by the growing and largely unrecognised power of Asia's consumers

AMERICAN consumers have been one of the main engines of global growth for the past decade. But now, as America's housing boom threatens to turn into a bust, many forecasters expect household spending to stall. A few even worry that America could come perilously close to a recession in 2007. Previous American downturns have usually dragged the rest of the world economy down, too. Yet this time its fate will depend largely upon whether China and the other Asian economies can decouple from the slowing American locomotive.

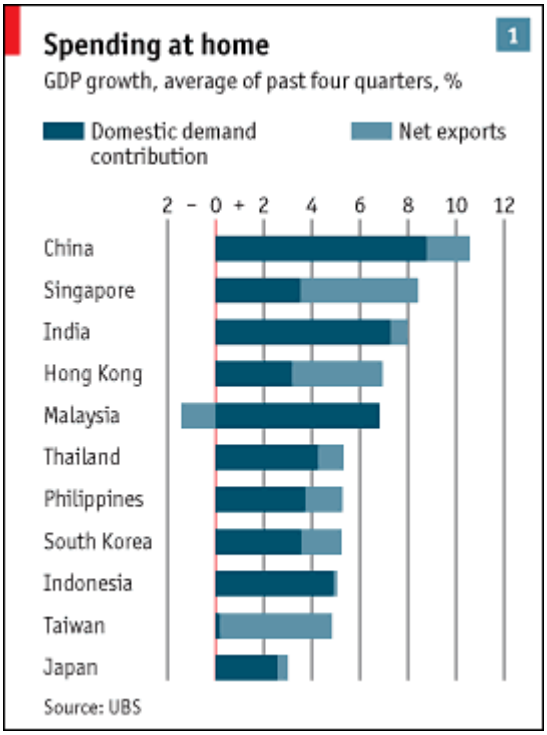
According to conventional wisdom, American consumers have single-handedly kept the world economy chugging along, whereas cautious Europeans and Asians have preferred to save. Yet the importance of America's role in global growth is often exaggerated. During the past five years America has accounted for only 13% of global real GDP growth, using purchasing-power parity (PPP) weights.

The real driver of the world economy has been Asia, which has accounted for over half of the world's growth since 2001. Even in current dollar terms, rather than PPP, Asia's 21% contribution to the increase in world GDP exceeded America's 19%. But current dollar figures understate Asia's weight in the world, because in China and other poor countries things like housing and domestic services are much cheaper than in rich countries, so a dollar of spending buys a lot more. If you want to compare consumer spending across countries, it therefore makes more sense to convert local currency spending into dollars using PPPs rather than market exchange rates.

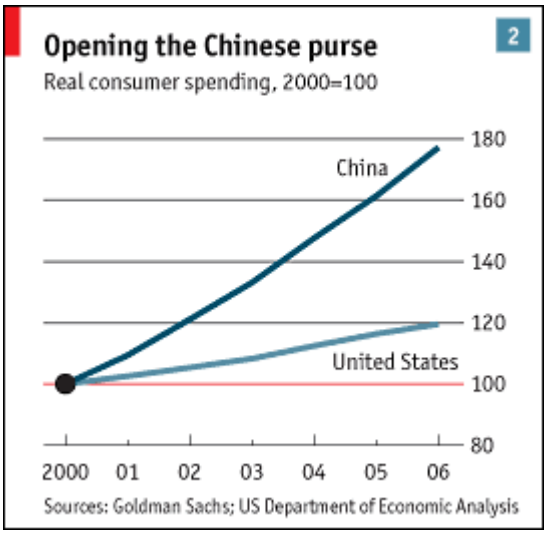
However, the doomsayers argue that Asia's growth has itself been based largely on exporting to America, whereas domestic demand in the region has languished. Their evidence for this is that Asia is running a combined current-account surplus of over $400 billion, implying that it is contributing much more to world supply than to demand. Thus if America's demand stumbles, the growth in Asia's exports and output would also plunge.

Asia's export growth would certainly slow sharply, but it is the

change in net exports that contributes to a country's growth rate, not the absolute size of that surplus. Since 2001 the increase in emerging Asia's trade surplus has added less than one percentage point a year on average to the region's average growth rate of almost 7%. Contrary to the received view, the bulk of Asia's growth has been domestically driven. True, domestic demand (investment and consumption) has grown more slowly than GDP over the past year everywhere except in Malaysia (see chart 1). But in most cases the gap has been small, especially in China, India, Japan and Indonesia. In contrast, growth in Taiwan, Hong Kong and Singapore has been heavily dependent on external demand over the past year.



It is true that exports account for 40% of China's GDP, but those exports have a large import component; only a quarter of the value of China's exports is added locally. The impact of a slowdown in export growth would therefore be partially offset by a slowdown in imports. China's GDP growth has come mainly from domestic demand, which has been growing by an annual 9% in recent years.



The idea that China's growth is mainly export-led is not the only popular myth. Another, says Jonathan Anderson, an economist at UBS, is that China's consumer spending is feeble. Several recent reports highlight that according to official figures spending has fallen from 50% of nominal GDP in 1990 to 42% today. But this partly reflects an even stronger boom in capital spending. Real consumer spending has been growing at an average annual pace of 10% over the past decade—the fastest in the world and much faster than in America (see chart 2).

There is also good reason to believe that official figures understate consumer spending in China because of their inadequate coverage of services. Purchases of homes by the Chinese have risen rapidly since they were first allowed in 1998, but these are also excluded from the figures. If they are added in, Mr Anderson calculates, total household spending has not fallen as a share of GDP.

How does this square with the common perception that Chinese household saving is extraordinarily high and rising? The truth is that it is not. The saving of Chinese households has in fact fallen from 20% to 16% of GDP over the past decade. The main reason why China's total national saving rate looks so high (at close to 50%) is that Chinese companies have been saving a much bigger slice of their booming profits (see article).

Bags and bags of shopping

Across many other Asian countries, the notion of the frugal Asian consumer is equally flawed, says Mr Anderson. Although consumption has fallen as a share of GDP in most Asian countries, this does not mean that households are saving more. Excluding China and India, household saving has fallen sharply, from 15% of GDP in the late 1980s to 8% today. The paradox is explained by the fact that wage incomes have risen more slowly than GDP as production has become more capital intensive. But this means that Asian consumers are spending a rising share of their income by borrowing or running down their savings. Amazingly, the savings rate of Japanese households has fallen more sharply than that of American households over the past decade.

The IMF estimates that in Asia as a whole (including Japan as well as the emerging economies) real growth in consumer spending has averaged a healthy 6.3% a year in 2005 and 2006. This suggests that Asian consumers can help sustain fairly robust GDP growth in Asia even if America's economy takes a dive.

Some pundits have predicted a boom in Asian consumer spending over the coming years, which would help to fill the gap left by American consumers cutting back on their purchases. But if consumer spending is already rising strongly in Asia, there is little pent-up demand ready to explode. On the other hand, spending by firms could pick up. After the Asian economic crisis in the late 1990s, investment plunged everywhere except China. It has remained relatively weak. However, as the overhang of excess capacity and debt has disappeared, capital spending is now starting to perk up across Asia.

Japanese firms' average return on assets now exceeds long-term interest rates by 5%, the widest margin for decades, according to Merrill Lynch. The Bank of Japan's latest Tankan survey of business confidence found firms to be unexpectedly cheery. Big Japanese manufacturers now report insufficient production capacity for the first time since 1991 and plan to increase capital spending by 17% in the year to March.

AFP

Doing their bit to help the world economy

Another reason for believing that Asian economies can decouple from an American downturn is that most of them have small budget deficits or even surpluses. This means they have plenty of scope to ease fiscal policy to support domestic demand so as to offset some of the fall in exports. The main exception is Japan, which has a massive public debt; Taiwan, where domestic demand is worryingly weak, is also constrained by a large budget deficit. South Korea, on the other hand, which has run a budget surplus for seven years, has plenty of scope to ease up.

The United States of where?

Not only is growth in China and the rest of Asia chiefly domestically led, but America's share of Asia's total exports has fallen from 25% to 20% over the past five years. Regional trade links within Asia have also deepened, thanks partly to growing Chinese demand. Goldman Sachs reports that five years ago China's imports for domestic use were only half as big as those for the assembly and re-export of products, but now they are roughly the same size. So strong domestic demand in China sucks in more imports.

China's exports to America have fallen from 34% of its total exports in 1999 to 25% now (adjusting for the re-exports which are made through Hong Kong). Chinese exports to the European Union are now almost as big as those to America and are growing faster.

America takes only 23% of Japan's exports, down from almost 40% in the late 1980s. However, this understates Japan's total exposure. Japanese firms (like those in South Korea and Taiwan) send a lot of components to China for assembly into goods, which are then exported to America as finished products. On top of this, if a sinking American economy pulled the dollar down with it, this would further squeeze Asian exporters.

When America sneezes, the rest of the world's economies may no longer catch a cold

A recent report by Peter Morgan at HSBC estimates that slower American growth will hurt China, India and Japan much less than it will the smaller Asian economies, such as Singapore, Taiwan and Hong Kong, that are more dependent on foreign demand. China, India and Japan account for three-quarters of Asia's GDP and so, given the deeper regional trade links, they should help to support demand in the whole region. If America's GDP growth slows next year to 1.9%, from 3.5% in 2006, as HSBC expects, then Asia's growth is tipped to slow from just above 7% this year to just below 6% in 2007. Weaker exports will badly hurt some industries, but overall, the region will continue to grow at a reasonable pace.

Could Asia withstand a sharper American slowdown? Hong Liang at Goldman Sachs estimates that if America's GDP growth drops to zero by the end of 2007 then China's annual export growth could plummet from 26% in early 2006 to a decline of 2% by late 2007. That sounds dire. Yet after taking account of the impact of slower export growth on imports and domestic demand (ie, slower growth in investment), Ms Liang estimates that China's GDP would still expand by a respectable 8%. That is significantly down from this year's growth rate of over 10%, which is still too fast to be sustained. China is today tightening policy so as to slow down its runaway economy: weaker external demand could be partly offset by reversing these measures.

In sum, if America suffers a slump, the economies of China and the rest of Asia would slow, but they are unlikely to be derailed. However, a slowdown in America could affect Asia indirectly through other channels. Most important and least certain of all would be the impact of an American recession on financial markets. Even if economies can decouple, global financial markets tend to be more tightly linked through the investment strategies of hedge funds and the like. If America's economy hits the buffers, this will surely trigger a rise in risk premiums and a drying up of market liquidity, pushing share prices lower in Asia as well as in America. When America sneezes, the rest of the world's economies may no longer catch a cold; but if Wall Street shivers, global tremors will still be widely felt.

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And what about Europe?

Standing on its own feet

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Developments in America matter less than those at home—or in Asia

FOR years continental Europe has been regarded as the weakling of the world economy, wheezing along behind healthy, trim America and young, gambolling Asia. Only with the occasional piggy-back from American consumers can the decrepit Germans, French and Italians make any progress at all. The thought of what an American slowdown, especially if coupled with a falling dollar, might do to the old continent is enough to make you shudder.

Save your sympathy. This year the strength of the euro area's economies has continued to surprise even optimists: GDP grew by 0.9% in the second quarter and may have managed 0.7% or so in the third, judging by robust data on industrial production and retail sales, and by business surveys. In 2006 the zone looks sure to chalk up its strongest growth rate since 2000. Best of all, for the past year or so it has been relying mainly on its own legpower: most of the growth has come not from trade but from domestic demand.

This demand has so far had more to do with Europe's firms than its consumers. Investment and additions to stocks made up more than half the GDP growth in the second quarter; and data on industrial production for the third quarter has looked strong. Consumption's contribution, however, has typically been less than its weight in GDP. As you might expect in a single-currency club of 12 countries, the pattern changes from one country to the next: especially in Germany, the biggest member, years of sluggish growth and worries about unemployment have made people reluctant to spend money.

No one really believes the pace of the past two quarters will last for long: it implies annual growth of 3%, which is more than the euro zone can sustain. And demand will probably take a knock at the start of next year, when Germany raises VAT and Italy increases income tax. That said, demand looks unlikely to falter altogether next year; and looking further ahead, some economists now think that the euro area's speed limit may be increasing.

Kevin Daly and Javier Pérez de Azpillaga, of Goldman Sachs, note that labour supply is being boosted by immigration, increased female participation and later retirement. Even if it is too soon to declare that a recent improvement in productivity growth is anything more than temporary, between 2008 and 2012 potential GDP growth may be 2.2%, compared with an actual average of only 2% between 1995 and 2005.

None of this means that a slowdown in America will leave Europe untouched. It will matter, but domestic affairs will count for more. And if they do worry about what goes on abroad, Europeans will perhaps be looking east rather than west. Last year, goods exports to America were, at €185 billion ($230 billion), only a little more than in 2001 (in euro terms; in dollars, they grew by more). Sales to Asia were, at €244 billion, €44 billion up over the same period.

On the import side, the change has been even more dramatic. In 2001 the euro zone's purchases from China alone, at €57 billion, were less than half those from America. In 2005 China sent €118 billion-worth of goods to the euro area, a whisker behind America's €120 billion-worth. Since the third quarter of last year, indeed, China has outstripped America as a supplier to the zone; now only Britain lies ahead.

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London as a financial centre

Capital City

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From The Economist print edition

Corporation of The City of London

Twenty years ago London embarked on a remarkable transformation to become a global financial centre. It now has to keep its lead

ONCE a year the Lord Mayor of London invites top financiers to the “City Banquet” at Mansion House, his official home. It is one of many opulent functions hosted by a Gilbert-and-Sullivan-sounding figure whose grand title harks back to the middle ages, when the Lord Mayor really did run the capital rather than act as an honorific salesman for its financial centre. But although the old City of London still celebrates its ancient traditions—today's Lord Mayor is the 678th—the new City has discovered a modern destiny as a hub of international finance since far-reaching reforms transformed the London stockmarket 20 years ago.

That revolution was called “Big Bang” because new ways of trading shares came into effect on one day, October 27th 1986. Just as the universe exploded after Big Bang, so the City has burst from its former boundaries around the old “square mile” of the Lord Mayor's domain and, in the process, redrawn the capital's skyline.

Twenty years ago, Canary Wharf was a wasteland in east London's docklands. Now it sprouts skyscrapers, including Britain's tallest, that provide palatial premises for global banks with giant trading floors. There are now almost as many financial staff working in just this one area as in the whole of Frankfurt, London's main European rival, says George Iacobescu, Canary Wharf Group's chief executive.

The City has also expanded to the west. Hedge funds have plumped for boutique offices in the choicer parts of the West End, like Mayfair. And a short cab-ride to the north at Marylebone, BNP Paribas employs 3,100 staff—the most in any of its buildings in the world—at a swish office that opened in 1997. The French bank's trading floor, with 850 desks and 2,550 screens, could double as a football pitch.

Within the square mile itself, the City's incessant demand for more space has led to a huge wave of new developments. To the east of the great dome of St Paul's Cathedral, built in the late 17th century, a cluster of 21st-century skyscrapers is planned as new towers with names like the “Helter-skelter” join the “Gherkin”, completed three years ago. Within less than a decade, the view from the Thames may look like the illustration above.

The property boom reflects the City's expansion since Big Bang. The specialist workforce that carries out

international financial business has risen by a half in the past 15 years, according to CEBR, a consultancy that monitors the London economy. These highly paid financiers, traders and professionals are now much more cosmopolitan. At BNP Paribas, for example, 35% of its staff in London are foreign nationals; less than half of these are French.

Few doubt that London's élan owes much to the revolution in its securities markets. “There is just no comparison now between the City's standing today and 20 years ago,” says David Lascelles, co-director of the Centre for the Study of Financial Innovation, a think-tank. “London wouldn't be in this position without Big Bang.” But can the City maintain its role as a global financial centre? Just this week the British government set up a taskforce, partly to signal to the City that it values London's standing. Other cities, not least New York, are keen to steal footloose financial transactions away. Exchanges are joining forces, making trading hubs, such as Chicago, potentially more powerful (see article). For all its historic success, London will be relentlessly tested in the future.

Club rules

Even before the revolution at the stock exchange, the City had defied historical odds by re-establishing itself in the 1960s and 1970s as the top international financial centre. Just as London had gained that position at the height of British economic supremacy in the 19th century, so New York might have been expected to take on the role after the second world war, when the dollar was pre-eminent. Instead heavy-handed regulations (such as interest-rate ceilings that made it unattractive to leave short-term deposits in America) drove international finance out of Wall Street. It found a ready home in London where the Bank of England monitored foreign banks with a feather-light touch.

By the early 1980s, the City had become an international banking bazaar. Walk down any of its narrow streets and you could enter banks from around the world; Moorgate was nicknamed “the Avenue of the Americas”. London played host to far more foreign banks than any other financial centre and had the biggest slice of the foreign-exchange market.

Business had gravitated to the City because its role was based no longer on sterling but on offshore currencies, predominantly dollars, held outside America. Yet there was a missing dimension. Although the City had opened up to the world in international banking, it had kept the shutters firmly closed in its stockmarket.

The London stock exchange was a closed shop, marked by an antiquated division between brokers who brought the business and jobbers who made markets in shares. Brokers were paid a fixed minimum commission on shares and gilts, which ripped off big clients, and jobbers lacked the capital to deal in big amounts. Trading in top British shares was starting to move to New York, where investment banks were able to offer keener prices because they could combine broking and market-making as well as underwriting new issues. The stock exchange was unable to reform because its rulebook was due to come under legal attack in a court case brought by the Office of Fair Trading. In July 1983 the exchange reached a historic deal with the Conservative government. The case was dropped. In return the exchange agreed to get rid of minimum commissions by the end of 1986.

Well before then, a bidding war had started for the stock exchange's Victorian-sounding member firms. In a giddy rush of deals, banks both domestic and international took stakes in virtually every broker and jobber worth having. Two British ventures raised especially high hopes. S.G. Warburg, a merchant bank that had pioneered London's eurobond market based on offshore dollars in the early 1960s, plunged into the fray. And Barclays, a high-street bank, created BZW, an investment bank, from its acquisitions.

Big Bang was a turning point in the City's postwar history, securing its position as a centre for trading international equities. The City signalled its welcome to foreign financial firms by sweeping away cosy club rules that protected domestic incumbents. American commercial banks, at that time unable to carry out securities business in the United States, were able to treat London as a laboratory.

By October 1986, the City already felt quite different. American investment bankers brought a brash new style to its financial markets, including breathtaking bonuses and early starts. The City, long notorious as a stuffy place where the old school tie mattered more than talent, became more meritocratic. The boisterous colour-jacketed traders in financial futures at LIFFE, a market founded in 1982, typified the new unbuttoned style of business.

Trading places

But after thriving for most of the 1980s, the City looked fragile ten years after Big Bang. The early 1990s brought recession to Britain and cuts in the number of City jobs. Then the two main British contenders as investment banks fell by the wayside. In 1995 S.G. Warburg was bought by the Swiss; and two years later, Barclays pulled the plug on BZW. As if this was not enough, Nick Leeson's rogue trading brought down Barings, a centuries-old merchant bank once called the sixth great power of Europe.

Pulling power

% share of financial-services markets, latest available

	Britain	United States	Japan	France	Germany	Others
Cross-border bank lending	20	9	8	9	10	44
Foreign equities turnover	40	34	nil	nil	3	23
Foreign-exchange turnover	32	18	8	3	5	34
Over-the-counter derivatives turnover	43	24	3	10	3	17
Marine insurance net premium income	20	11	12	6	8	43
International bonds (secondary market)	70	na	na	na	na	na
Hedge-fund assets	21	66	2	1	nil	10

Source: International Financial Services London

Ahead loomed the euro. The risk was that footloose financial firms might forsake the City and cluster instead in Frankfurt, home of the new European Central Bank. The fears proved groundless. Far from undermining London, the euro strengthened the City's grip in European finance, says Douglas McWilliams, chief executive of CEBR. With the fading of the small centres that had specialised in bilateral trading between the former currencies, London dominated euro trading.

Over the same period, London surfed the next big breaking wave of products. Although Euronext took over LIFFE in 2002, 98% of the value of the Paris-based exchange's trading in derivatives was done in London last year. More important, the City secured a commanding stake in “over-the-counter” derivatives, which are traded off exchanges primarily with banks. The value of these commitments is now four-to-five times greater than those on exchanges owing to investors' ravenous appetite for financial products that parcel up and repackage risk. London's share of this booming market has risen from 27% of daily turnover in 1995 to 43% in 2004.

Some of the biggest customers for derivatives are hedge funds, which offer sophisticated investors opportunities to gain from trading strategies (for example, making money in falling stockmarkets) as well as through asset allocation. Here again, London has elbowed its way into a high-growth financial industry. The global value of assets in hedge funds has doubled since the end of 2002 to reach $1.2 trillion. Although the industry is dominated by the east coast of America, investments managed out of London are worth a fifth of the world total, up from a tenth in 2002, and almost four-fifths of those in Europe.

The City's record over the past two decades has not been an unqualified success. International insurance has been a weak spot, in part because of the travails of Lloyd's of London, a market founded in a coffee house in the 17th century that was hit by 20th-century scandals and huge losses from asbestosis claims. London's share of net premium income in marine insurance, a traditional mainstay of Lloyd's, has shrunk from around 30% in the mid-1980s to 20% in 2005.

Set against that, other less salient parts of the City have been thriving. Shipping services have made a recent comeback; overseas earnings rose by a quarter between 2002 and 2004. London's 400 shipbroking firms match ships and cargoes in 50% of tanker chartering. And there has been a spectacular growth in legal services, which are vital in backing the work of a global financial centre. Over 200 foreign law firms have offices in London, which is also headquarters for three of the four largest firms in the world. Exports from Britain generated by international law firms are now three times higher than they were in 1995.

Centre court

London is a textbook example of an economic cluster, in which businesses locate close to one another because they gain from proximity. “The big warehouse of markets is in London,” says Pascal Boris, chief executive of BNP Paribas's British operation. The distinctive feature of the City cluster is the pre-eminence of foreign financial firms. In this sense, London has become to finance what Wimbledon is to tennis: a place where the best international players come to compete.

Yet modern communications and information technology allow people and businesses to operate from virtually anywhere nowadays. And there are obvious disadvantages in locating at the heart of a metropolis. Property costs are extremely high in London by international standards. Public transport is overcrowded and often unreliable.

The City's vibrancy shows that it offers compelling advantages that outweigh these drawbacks. Financial firms cluster in London because they derive external economies of scale. By thronging together, they create large, liquid markets that drive down trading costs and reduce risks by allowing large deals to be handled.

There are further benefits from locating in the cluster. Firms, large and small, can call upon all the external services needed to put together a complex financial deal, such as advice from lawyers and accountants, or the use of specialist markets. This in turn creates a fertile environment for innovation to flourish—a vital attraction for a global financial centre.

Underpinning the hub is access to talent. Firms locating in London can tap into a huge specialist financial workforce drawn from both domestic and foreign sources. “It becomes a self-fulfilling prophecy,” says Mr Boris. “If you want to be hired you go to where people will hire you: London is this magnet in Europe.”

A continuing tradition of “light-touch” regulation has proved to be another essential ingredient. In 1997 the new Labour government announced reforms to replace what had become an untidy muddle of statutory and self-regulatory bodies with one regulator. This offered the advantage of a single port of call for the City's big financial conglomerates, but held the risk that they might get unduly caught up in rules to protect the individual consumer. In 2004 the Financial Services Authority responded by introducing a separate division for wholesale and institutional markets, headed by Hector Sants, previously an investment banker. “We recognise,” says Mr Sants, “that good regulation is a key component of a successful marketplace.” The FSA is now highlighting the need for regulation to be based on principles rather than detailed prescriptions.

But if the FSA has seen the light, European directives that pay insufficient heed to the City's unique position increasingly tie the regulator's hands. These absorb 85% of the FSA's policy time, says Mr Sants, who sounds a cool note about the worth of the latest directive—on markets in financial instruments—for the City. Against this background, Mr Lascelles gives the FSA grudging praise: “It's not so much that it has been good but that it has been less bad than elsewhere.”

America's ability to score regulatory own goals continues to help the City. The Sarbanes-Oxley legislation, passed after the collapse of Enron in order to stiffen up corporate governance, has put off foreign companies from listing there. The London Stock Exchange (LSE) has been the big beneficiary. Foreign firms have flocked to list on its main market and AIM, a less regulated market that it established in 1995.

In an ironic coda to Big Bang, which saw the stock-exchange's member firms gobbled up by foreign owners, the LSE—since 2001 a listed company itself—is under siege from NASDAQ, an American exchange, which already owns 25% of its shares. Tellingly, the government's only worry about the deal is that it could lead to a back-door introduction of heavy-handed American-style regulation—a threat it will block through a change in the law. That apart, it is unfazed by the prospect of this citadel of British capitalism falling to a foreign predator.

London's success as the Wimbledon of international finance is now such that New York is trying to fight back. Michael Bloomberg, its mayor, has called in McKinsey, a management consultancy, for advice. But Mr Bloomberg will find it difficult to alter America's regulatory approach. Lawmakers in Washington, DC, are generally swayed by domestic rather than international concerns.

Some recent talk about London has smacked of hubris, confusing its success as a financial centre with the favourable cyclical conditions that investors and traders have been enjoying. That froth will be skimmed away by tighter money and a slowing world economy.

However, the City will be hard to dislodge as a financial hub. Sir David Walker, who worked behind the scenes in the early 1980s to reform the stock exchange and is now a senior adviser to Morgan Stanley, an American bank, gives warning against complacency but says: “Over time a virtuous circle, supported by sensible regulation, has developed to such an extent that London is more than a network: it's become a knot and it's very difficult to disentangle a knot.”

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Buttonwood

Developing nicely

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A health check for emerging markets

EMERGING markets are growing up. They are bigger, stronger and less prone to contagious infection. No longer are they an exotic asset brought in to spice up investors' portfolios. No serious investor can afford to ignore them.

Earlier this year, the value of shares on the MSCI Emerging Markets index passed $2 trillion for the first time. As recently as 2002, the index, which groups the shares of 25 big developing countries, was worth only $500 billion.

The debt markets have also improved a lot. According to America's Mellon Asset Management, around 40% of emerging-market debt is now rated “investment grade”, which means it can be held in mainstream portfolios. A decade ago, the proportion was just 3%.

And because it has put its own house in order, the developing world is now less dependent on handouts. Loan disbursements from the International Monetary Fund have run at just SDR1.9 billion this year ($2.8 billion), down from SDR26.6 billion in 2002. In contrast, developing countries attracted a record $334 billion of foreign direct investment last year.

Furthermore, even though emerging markets wobbled in May and June, there was nothing like the panic (nor the wider economic impact) seen in 1994-95 after the Mexican peso devaluation, or in 1997-98, with the Asian crisis.

Over the past few months, emerging markets have recouped most of their losses, and shares are showing a double-digit percentage gain on the year. Investor confidence has returned. ING, a Dutch bank, says that, in the week ended October 11th, emerging-market bond funds received their highest inflows since March.

Just eight years ago, many investors seemed to have deserted emerging markets for good. The sector had delivered the dreadful combination of low returns and high volatility. The “Asian miracle” seemed to have disintegrated. Investors were more interested in emerging industries, such as technology and mobile telecoms, than in emerging countries.

But conditions in the past few years have been much more favourable. Andrew Howell, a Citigroup strategist, says the environment has been “as good as it gets. Interest rates have been low and commodity prices have been high.”

Commodity producers, such as Russia, have benefited from very high raw-materials prices whereas for consumers, such as China and India, the gains from higher global activity have more than offset higher commodity costs.

Most developing nations seem also to have learnt their lesson from the excesses of the 1980s and 1990s. They have freed their exchange rates, avoided a dependence on short-term capital flows and steered clear of running up massive current-account deficits.

The improvement has not been universal. There are still countries, such as Turkey and Hungary, where the current-account deficits are too high and the currencies look vulnerable. Earlier this year, a sudden sell-off in Iceland showed how quickly investors can desert a market.

But the long-term case looks impressive. Emerging markets still only make up 7-8% of the total value of world stockmarkets, according to Merrill Lynch, whereas they comprise 24% of world GDP, at market exchange rates. There is a lot of scope for emerging markets to catch up, in terms of both output per head and market capitalisation relative to GDP.

This argument can be carried too far. Much of the rise in market capitalisation will result from more companies issuing shares as they float on local stockmarkets, rather than from rising share prices.

In valuation terms, emerging-market shares now stand at a 15-20% discount to developed markets. That is much less of a bargain than the 60% discount that they offered in 2002. But it is rather better than the premium rating reached in 1994, at the height of investor enthusiasm.

Encouragingly, for those of a contrarian bent, the latest Merrill Lynch survey of global fund managers found that most investors are underweight in emerging-market shares at the moment.

Debt valuations look rather less favourable. The spread between emerging-market and treasury bond yields reached a record low of 169 basis points (a bit over one-and-a-half percentage points) in April and is still only around 185 points. However, not only has the financial position of developing countries improved, the creditworthiness of America has deteriorated (thanks to the current-account deficit). Thus, a narrowing of the spread is justified.

Another sell-off in emerging markets cannot be ruled out; much depends on global growth next year. But developed markets can plunge too, as they did in 2000-02. No grown-up investor can afford to have less than 5-10% of his portfolio in emerging markets these days.

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Futures exchanges

Chicago bulls

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A merger to create the world's biggest exchange puts the wind up its rivals

MORE than two decades ago Terry Duffy and Charles Carey both got their start in life trading hog futures in the chaotic open-outcry pits of Chicago, places dominated by burly men with loud voices and sharp elbows. On October 17th the two chairmen did the trade of their lives: they shook hands on an $8 billion deal in which the Chicago Mercantile Exchange (CME) would buy the Chicago Board of Trade (CBOT). They aim to create the world's biggest financial marketplace, allowing investors to buy and sell financial futures in everything from interest rates to government bonds, stock indices, currencies, gold and, yes, pork bellies. With one smart move, the Chicago boys have sent waves around the world.

Far from being a simple cross-town deal, the merger plan unites two world leaders in the exchange-trading of derivatives, a fast-growing form of finance. Together they trade more than 9m contracts a day worth a notional $4.2 trillion. Should the deal win shareholder and regulatory approval, the market value of the combined entity, now about $25 billion, would surpass that of the New York Stock Exchange (NYSE), or Eurex, a German-Swiss derivatives giant. More importantly, it will put pressure on rivals such as the NYSE to pull off their own transatlantic merger plans. And it ups the ante for any exchange trying to seize a strong role in derivatives.

The competition has good reason to envy Chicago. Its exchanges are joining forces at a time when others trying to consolidate—particularly in Europe—have tripped over shareholders, regulators and each other. Yet the urge to merge is compelling. Clients, such as hedge funds, have the technology to trade across different sorts of assets in increasingly complex strategies. Now they want exchanges to offer a place to do this with as little cost and as much liquidity as possible.

Steve Rodosky, an asset manager at PIMCO, a Californian firm that manages $700 billion, says the CME Group, as the merged entity will be called, should make it easier and cheaper to trade bundles of futures, such as treasury and eurodollar futures, that are now split between the exchanges. The CME and CBOT project at least $125m in cost savings from the merger, hinting that some of this could go into price cuts. But these are far from assured. After Eurex announced a plan to challenge the CBOT's monopoly in American treasury futures in 2003, the Chicago exchange cut its fees only until the Europeans had been defeated. It has since raised them twice.

With this in mind, and an eye on the regulators who will be fathoming the antitrust considerations, some brokers are arguing that a reduction in the number of exchanges in America will push up fees. “My initial reaction is 'show me the benefits,'” says Gary DeWaal of Fimat, a global brokerage firm. He notes that futures exchanges do not have to pool the clearing of their trades, as stock exchanges do, which gives them added control. Such practices could face scrutiny from the Commodity Futures Trading Commission and the Department of Justice, which will both review the deal.

Rival exchanges are already accusing Chicago of a protectionist motive. “This looks like a plan to shut other people out,” says a spokesman for Euronext, a pan-European exchange operator, which hopes to sell more derivatives products in America through its LIFFE exchange if its tentative merger with the NYSE goes ahead. For Deutsche Börse, parent of Eurex, news of the merger must be even more depressing. Eurex will lose its world leadership in derivatives. That is likely to make the Germans more persistent in their push to create a pan-European exchange. But Euronext has repeatedly rebuffed them and the Germans earlier dropped a bid for the London Stock Exchange—which, with no derivatives business of its own, must also be worried.

Messrs Duffy and Carey next may well steal a march into territory outside America and Europe. At a conference in Brazil this week, the head of the Milan bourse announced a co-operation agreement with

the Brazilian and Mexican exchanges and Euronext moved closer to Taiwan. All will have been jolted by the news from Chicago. None will be able to ignore it.

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About sponsorship

Hedge funds

Frontier justice

Oct 19th 2006 | FRANKFURT AND NEW YORK
From The Economist print edition

Facing calls for transparency, hedge funds try self-policing

THERE is a bit of the frontier spirit about hedge funds—albeit one of algorithms rather than Apaches. Until recently, they have kept their heads down at any talk of regulation. But as pressure mounts for more external oversight of a $1.2 trillion industry that is taking a growing share of the world's pension investments, some funds are muttering, through gritted teeth, of the need for self-policing.

The demand for more light to be shed on hedge funds has reached a level not seen since the near-collapse in 1998 of Long-Term Capital Management (LTCM), a vast hedge fund. The $6.5 billion loss incurred last month by Amaranth Advisors, a Connecticut-based fund that took bad bets on natural gas, reopened the regulation debate in America's Congress.

In Europe calls for more transparency were taken up on October 16th by Edgar Meister, chairman of the supervisory committee of the European System of Central Banks. He said hedge funds operate in a "supervisory no-man's land". That is not always so, because regulators keep an eye on them through the banks which trade with them. But he suggested there should be a voluntary code of conduct.

In America the latest allegations are that hedge funds trade on inside knowledge, particularly in credit markets. The problem is that they not only make loans, which give them access to private information, but also trade them or the derivatives linked to them. The "Chinese walls" between holders of private and public information usually held firm when the market was dominated by banks with big compliance offices. But as hedge funds move in, there are fears of leakage.

Actual abuse is hard to prove, of course. But analysts point to suspicious price movements in the run-up to takeover offers (for HCA, a health-care group, and Harrah's, a casino operator, for instance) and when bad news is broken to lenders (as at Movie Gallery, a film-rental chain). "It's clear that a few players have their fingers in the pot," says Chris Dialynas of PIMCO, an investment firm. America's Securities and Exchange Commission—which is reported to be looking into the Movie Gallery case—describes insider trading by hedge funds as being "of significant concern".

The industry is hoping it will be left to heal itself. On October 16th the Loan Syndications and Trading Association, whose members include banks and hedge funds, issued guidelines designed to curb the abuse of information. Elliot Ganz, its general counsel, predicts that funds will comply as "the last thing they want is damaging investigations because one trader got out of control." There is also talk of creating a self-regulatory body with powers to discipline wayward hedge funds.

Hedge funds fear pressures could get worse if regulation-friendly Democrats regain control of Congress in next month's mid-term elections. States such as Connecticut, where many hedge funds are based, are also fingering their sheriff's badges. Parallels are being drawn with Eliot Spitzer, New York's attorney-general and the scourge of Wall Street. No wonder the industry is circling its wagons.

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About sponsorship

Discount share trading

"Low touch", but no soft touch

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Brokers can still make money. But not from brokerage

WITH the Dow Jones Industrial Average passing 12,000 for the first time this week, middlemen should be as happy as investors. When shares do well, people trade them more. Indeed, 2006 is already the most profitable year ever for the biggest discount broker, Charles Schwab, which this week announced a 29% leap in earnings in the year to the third quarter.

Schwab was one of the first to slash the price of equity trades in 1975, when fixed brokerage commissions were abolished. In doing so, it offered the average American his first chance to invest cheaply and directly in the stockmarket. Dozens of traditional stockbroking firms went belly-up. Schwab and other upstarts made billions.

But the business they have conquered is less lucrative as a result. Discount broking in the internet age has become "commoditised". With nothing to differentiate brokers, their prices are converging—and falling. Friedman, Billings, Ramsey (FBR), an investment bank, reckons trading commissions have plummeted by almost a third since 2000, and by even more if higher-margin option trades are excluded. Some observers believe commissions could disappear entirely. In pockets of the industry, this is already happening. Last week Bank of America announced it would offer free online trades to customers with lots of cash in their bank accounts. Wells Fargo, another bank, has a similar offering. Earlier this month, Zecco, a new free-trading platform, was launched to some fanfare.

All of this took a heavy toll on the share prices of Schwab and its two big competitors, E*Trade Financial and TD Ameritrade. But they appear unconcerned—at least publicly. Trading is no longer their sole bread and butter. Of the $1.3 billion in revenue Schwab booked this quarter, only 13% came from trading. The rest was made in asset management, the distribution of mutual funds and banking. E*Trade, which has expanded its banking business significantly in recent years partly through acquisitions, counted on trading for only a third of its revenues in the second quarter. Even Ameritrade, which stuck to the trading model longer than its peers because it had a lower-cost platform, made only 40% of its revenues from trading last quarter.

The squeeze on commissions is only one factor in this transformation. Whereas online brokers once fought to attract fidgety, active traders, today they are jostling to bring in long-term investors, who might bank, trade and invest under one roof.

But they will not have these investors to themselves. Banks, brokers and asset managers are vying for the cash of the same customers. The competition is pushing up the rates offered on deposits (some online banks are paying as much as 6% on current accounts) and pushing down commissions on mutual-fund transactions, option trades and other deals.

Discount brokers peddle a "low-touch" service, heavily reliant on e-mail, telephones and technology, not firm handshakes. Will this appeal to richer, more demanding clients—the types accustomed to full-service brokers like Merrill Lynch and UBS? So far clients do not seem to miss the heavier touch. In the third quarter, Schwab outpaced Merrill Lynch, which also reported its results this week, in new client assets ($21 billion to Merrill's $14 billion), narrowed the gap in total assets ($1.3 trillion to Merrill's $1.5 trillion), and reaped fatter profits. Not bad for an upstart.

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Economics focus

Profits and prophecies

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Chinese companies earn higher returns than is commonly claimed

IT MAY be the world's fastest-growing economy, but do China's firms make healthy profits? This is the subject of a lively debate* among economists, investors and businessmen. According to the conventional wisdom, Chinese companies use capital inefficiently and have enormous overcapacity. As a result, profit margins are thin and falling, and heavy borrowing to finance unprofitable investment puts the banking system at risk.

However, Bert Hofman and Louis Kuijs, two economists in the World Bank's Beijing office, disagree. According to their analysis, based on figures reported to China's National Bureau of Statistics (NBS) by more than 200,000 state-owned and private companies, the profits of industrial companies have soared by an average of 36% a year since 1999. The average pre-tax return on equity by state-owned firms increased from 2% in 1998 to 13% in 2005; private companies' return went up from 7% to 16%. Furthermore, most corporate investment is now financed out of companies' own cashflows and only one-third from outside sources, such as banks.

This view was attacked in an article in the *Far Eastern Economic Review* by Weijian Shan of TPG Newbridge, one of the most successful private-equity firms in Asia. Mr Shan, an old hand at evaluating Chinese firms, says the World Bank is “deluded”: most Chinese firms make little profit, their margins are being eroded, and their investment boom is being financed largely by lending from state-controlled banks. Who is right? The answer is important for policymakers as well as for investors. If the return on capital is indeed low and falling then today's pace of growth will prove unsustainable.

Mr Shan says that it is nonsense to argue that high profits are driving investment when business as a whole is such a big borrower. Total bank credit is bigger than the country's GDP, which is exceedingly high by international standards: in America the ratio is only 44%. Yet borrowing says nothing about the strength of profits. Firms can have high retained earnings (ie, saving) yet still need to borrow if they invest more than they hoard. Hong Liang, an economist at Goldman Sachs, argues that the high ratio of credit to GDP in China partly reflects the immature state of the country's securities markets. Corporate bonds amount to only 4% of GDP compared with over 100% in America. Ms Liang's analysis supports that of the World Bank: she calculates that the debt-to-equity ratio of Chinese industrial firms has fallen from 1.8 to 1.4 over the past decade as firms have financed more investment from profits rather than borrowing.

It is true that gross lending to firms is much bigger than lending net of deposits, which the World Bank focuses on. Profitable firms deposit their saving in banks, which then lend it to less profitable ones. The stock of bank debt and hence the risks of bad loans may therefore still be large.

Mr Shan insists that excess capacity, soaring commodity prices and flat or falling prices for finished goods are eroding profit margins. Using the same data as the World Bank, he calculates that gross margins fell from 18% of sales revenue in 1999 to 15% last year. But gross margins take account only of the direct costs of production; they exclude selling, distribution, administrative and financial costs, which have all risen more slowly. After deducting all costs Messrs Hofman and Kuijs reckon that profit margins have risen from less than 3% in 1999 to almost 6% in 2005.

But surely Mr Shan has a point: how can profit margins increase when wages and raw material prices have been rising so rapidly? Since 1998 wages have gone up by no less than 14% a year, while export prices have fallen. The explanation is that productivity has grown even faster than wages, expanding by 20% a year in industry, cutting unit labour costs. As a result, the share of national income going to workers has declined, while that to firms has increased. Profit margins were squeezed slightly in 2005, as commodity prices shot higher, but this year they have widened again.

Efficiency gains

The improvement in average profits should not be a surprise, as it partly reflects productivity gains in the wider economy. The growth rate in China's total factor productivity (the efficiency with which both capital and labour are used) has been one of the fastest in the world over the past decade, thanks to the expansion of the private sector, as well as a substantial restructuring of state-owned firms.

How reliable are the profit data? The NBS figures exclude taxes and include subsidies. This should not affect the trend in profits over time. Moreover, government subsidies to business are now negligible.

Since profits and capital spending have boomed hand in hand, what has happened to the return on capital? Ms Liang estimates that it has risen steadily since the late 1990s, unlike in the early 1990s investment boom, when it plunged. For those sceptical about the NBS data she also analyses the profits of Chinese companies listed overseas, whose finances are audited according to international accounting standards. The average return on equity in China is similar to that in America and Europe (see chart, above). An independent study published by the OECD last year also found big gains in the return on capital of Chinese firms. In 2003 the average rate of return for private-sector industrial firms was higher than the average in developed countries.

Even if total profits are booming, China still has many corporate duds. A fifth of all industrial firms (and a third of state-owned enterprises) continue to lose money. Experienced investors also know that even if they find a profitable firm, all too often they fail to provide foreign investors with a decent return. This is good reason for investors to tread carefully. However, for the economy as a whole, China's rising profits should promise more years of strong growth ahead.

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Facial characteristics

Your mother's smile

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Evidence mounts that making, and perhaps recognising, expressions is inherited

Photodisc

CHARLES DARWIN once noted that he had no great quickness of apprehension nor wit, nor power to follow a long and purely abstract train of thought. What made him “superior to the common run of men” was his ability to notice things that can easily escape attention. Thirteen years after publishing “The Origin of Species”, Darwin produced a lesser-known book in which he argued that animals, like people, feel emotions and express them using their faces. Humans, he thought, were not alone in opening their mouths when listening, pursing their lips when concentrating or touching faces with loved ones.

Darwin also believed babies are born able to recognise the facial expressions of others. His first child had suddenly assumed a melancholy expression in an experiment where the maid pretended to weep, even though the boy had apparently never before witnessed another person crying. This, Darwin thought, suggested that his son could not have learned that crying is linked to sadness and must have somehow inherited the knowledge.

Modern biologists have avoided experimenting with babies and eschewed linking animal “expressions” with human ones, for fear of committing the zoologists' sin of anthropomorphism. Nonetheless, Darwin's argument for the inheritance of facial expressions is gaining credence, most recently from an experiment by Gili Peleg and colleagues of the University of Haifa, in Israel. Instead of babies and animals, they used blind people.

It is obvious that a characteristic has been inherited in diseases such as haemophilia and traits such as naturally red hair: such things cannot be moulded by experience. But to tease apart what can be learnt about forming facial expressions from what is genetically programmed, Ms Peleg had to find people who could not have copied those around them.

Expressions of interest

Congenitally blind people fall into this category. In a recent paper in the *Proceedings of the National Academy of Sciences*, Ms Peleg describes filming 21 interviews with people who have been blind since birth, and 30 interviews with normal-sighted people, all of whom were genetically related to her blind

subjects. Ms Peleg asked her volunteers to give detailed descriptions of experiences that caused them to feel sad, angry, disgusted and joyful. As they did so, their faces expressed the appropriate emotion. She then gave her volunteers a puzzle and kept the camera rolling as their faces demonstrated concentration. She induced expressions of surprise by interrupting concentration with a nonsensical question.

Next, with a stamina for detail that would have impressed Darwin himself, Ms Peleg watched the recorded interviews and listed the parts of the face that moved when each volunteer expressed each emotion. In doing so, she created a numerical “expression signature” for everyone in the study and gave herself something to compare using statistics.

First, she looked at each emotional state separately. For anger, sadness and concentration, the detailed ways that blind people moved their faces were significantly more similar to those of their family members than to those of strangers. But the differences she found for disgust, joy and surprise were not great enough to draw any firm conclusions. Second, she analysed the expression signatures—that is, the aggregate measure of all the emotions—to see whether they gave her enough information to match blind and seeing family members. They did, allowing her to place 80% of the people into the correct family group. In fact, even the angry expressions alone were variable enough to classify her volunteers into families 75% of the time.

Some of this family resemblance is certainly a consequence of similar muscular and skeletal structures underlying the face. Some of it is also likely to be the result of unlearnt instructions emanating from the brain. Either way, it would delight Darwin.

How the brain recognises these facial expressions, however, is unclear. One intriguing possibility is that the brain recognises emotions in a similar way to that in which it identifies individuals. That is an implication of unpublished research using macaque monkeys by Doris Tsao and Winrich Freiwald, of the University of Bremen, in Germany.

The pair recorded how cells in a region of the brain devoted to facial recognition, called the fusiform face area, code the information. They categorised facial dimensions such as the distance between the eyes, then recorded the electrical activity of one brain cell at a time while they showed cartoons to the macaques. This allowed them to correlate the facial characteristics of each drawing with the firing patterns of the cells. Each cell appeared to be tuned to up to eight different facial dimensions. The results provide one mechanism by which the brain could gather information on expressions. For example, the pair found cells sensitive to slanted eyebrows, which could be relevant in recognising anger.

However, another study, presented this week at the annual Society for Neuroscience conference, in Atlanta, cast doubt on the idea that the mechanisms for facial recognition and reading emotions are tightly linked.

Brad Duchaine of University College London studied eight siblings from a family that suffers from a condition known as prosopagnosia, or the inability to identify people from their faces. He found that their disability seems to run in families, but that people with prosopagnosia could nevertheless understand the facial expressions of others. Unless prosopagnosia sufferers were co-opting parts of the brain that those without the condition use for other purposes, that suggests reading faces and reading emotions are different processes.

Identifying individuals and reading the emotional state of others is an advantage among animals that form societies. That said, facial expression does not seem to be a prerequisite for such interactions. Ants, bees and wasps form complex communities but do not seem to rely on facial characteristics for their communication. Yet no one doubts that bees get angry, as Darwin himself pointed out.

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Nuclear physics

Magical shell game

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Russian and American researchers have discovered the heaviest element yet

BEING forced to rewrite the textbooks every so often is no bad thing. Now scientists are poised to oblige the producers of that perennial classroom classic, the periodic table, to issue an updated version. They have synthesised a new element that is the heaviest ever made. Such a discovery was first announced, and then retracted, some years ago. This time, the researchers are confident that they have truly found it.

Hydrogen, the lightest element, has a single proton whereas uranium, the heaviest naturally occurring one, has 92. The new discovery, known as element 118, is so called because it has a total of 118 protons in its nucleus.

For years, two groups have raced to create ever-heavier elements. One team, based at the Lawrence Berkeley National Laboratory, in California, reported in 1999 that it had succeeded in creating two atoms of element 118. But in 2001, after failing to reproduce the results and finding that some of the data were suspect, the result was retracted. Now the other group, based partly at the Joint Institute for Nuclear Research in Dubna, near Moscow, and partly at the Lawrence Livermore National Laboratory, in California, is claiming victory. In the current issue of *Physical Review C*, the researchers, led by Yuri Oganessian, describe finding three atoms of the stuff.

The researchers fired a beam of calcium ions, each containing 20 protons, into a target of californium, a highly radioactive synthetic substance with 98 protons. The idea was to get one of each type of atom to stick together to become a single atom of element 118. Over many months, they fired some 10 million, million, million (that is, 10^{19}) such ions into the target. Just three atoms of element 118 were created. As these lived for less than a thousandth of a second, their presence was ascertained by examining the daughter atoms into which they quickly decayed.

That element 118 does not persist for long is interesting in itself. For the past 40 years, theorists have speculated that there should be an “island of stability” that would grant heavy elements a relatively long life if they had precisely the right number of protons and neutrons.

Under the laws of quantum mechanics, the nuclei of atoms have shell-like structures analogous to the spheres in which given numbers of electrons exist in certain orbits around the nucleus. The most stable atoms, that is, the ones that take the most time to decay, contain “magic numbers” of protons and neutrons that produce complete, closed shells unable to accommodate any more protons and neutrons.

The numbers 2, 8, 20, 28, 50 and 82 are magic for both protons and neutrons. At higher numbers, the pattern is less clear. The highest known magic number for neutrons alone is 126. Lead, with 82 protons and 126 neutrons, is thus “doubly magic” and the heaviest stable isotope in the periodic table. The one after that for neutrons is thought to be 184, out of reach of today's experiments. But theorists disagree on what might be the next magic number for protons. To see whether the next magic number is nearby in the periodic table, the experimenters will now try to produce element 120 by bombarding a plutonium target with a beam of iron ions.

As for updating the periodic table, element 118 would slot in just below radon in the column that contains inert gases. But its inclusion, and its receiving an official name, will have to wait until other researchers reproduce the results. That requires a second, separate laboratory capable of synthesising new elements. But the machine best suited for doing this work, the proposed rare-isotope accelerator that could be built either at Michigan State University or at the Argonne National Laboratory in Illinois, has been delayed by lack of funds. The periodic table would appear thus to have won a temporary reprieve.

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Neuroscience (1)

Calm the anxiety, help the child

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New therapies for some aspects of Rett syndrome may be on the horizon

BIOLOGISTS routinely give human diseases to rodents in an attempt to learn what has gone awry in people. Sometimes the result mimics the human condition better than others, but rarely is the rodent version so accurate that it surprises even the scientists who made it. Such is the case with a mouse form of Rett syndrome that has helped to identify a promising new treatment for people.

Rett syndrome is a complex neurological disorder that was first described in 1966 by Andreas Rett, an Austrian doctor. It affects mainly girls. Most of the people who have it are profoundly and multiply disabled, and highly dependent on others throughout their lives. Between the ages of six months and 18 months, children with the syndrome become mentally retarded, wring their hands repeatedly, suffer from anxiety and often have difficulty walking and breathing. Although the severity of symptoms and the age at which they manifest themselves varies, Rett syndrome has just one cause: mutations in a single gene called *MeCP2*.

Huda Zoghbi of the Baylor College of Medicine in Houston, Texas, and colleagues, who discovered this fact, wondered whether the syndrome is the result of a mutated version of *MeCP2* failing to repress other genes, making them overly active. If so, the other genes would be causing the various physical and mental problems that affect sufferers. The researchers developed a way to test their idea in mice and presented the results at the annual Society for Neuroscience conference held this week in Atlanta.

To keep things straightforward, the researchers chose to work with mice who carried just one copy of the gene. As *MeCP2* resides on the X-chromosome, this meant studying male mice as females have two X-chromosomes. Studying these creatures, Dr Zoghbi saw that the rodents with a mutant form of the gene were affected similarly to people: they developed tremors and spasticity in their forelimbs, became susceptible to seizures and suffered breathing problems.

But the mice also developed the psychological aspects of the disease. People with Rett syndrome withdraw socially and recently scientists have found that up to 75% of patients are so anxious that a stress hormone called cortisol can be found in their urine. The mice also spent less time with other animals, preferred closed spaces and trembled noticeably when handled by the scientists. The animals produced abnormally high levels of the stress hormone, which is called corticosterone in mice.

The team therefore started hunting for the exact molecular cause of the anxiety. A likely culprit was a small peptide called CRH that is released in a part of the brain associated with stress and anxiety. They found that the peptide was overly abundant in the mutant mice, and that its expression was usually repressed by the normal version of *MeCP2*.

The results point to a likely therapy. From past work, scientists know that mice that lack the molecular receptors needed to detect CRH are less anxious than normal animals. Thus, Dr Zoghbi predicts that knocking out the receptors with drugs will help calm the animals.

The best part, she says, is that such a drug already exists, is known to be safe, and is already used in humans for the treatment of depression and anxiety. Thus, if the drug calms the mutant mice, the team could soon start clinical trials in people with the syndrome.

Although the drug is unlikely to relieve all of the symptoms of the disorder, decreasing anxiety in people with Rett syndrome may mitigate symptoms including learning difficulties, the inclination to withdraw socially and even the tendency to hyperventilate. Such a drug would be a comfort to sufferers and their carers.

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Neuroscience (2)

Use it or lose it

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Learning protects newly formed brain cells in adult mammals

KEEPING mentally agile protects against dementia but until now no one has known exactly why. One possible reason was revealed at this week's annual Society for Neuroscience conference in Atlanta—at least, for rats. Thousands of new brain cells or neurons grow each day in the brains of rats and, presumably, in the brains of people, too. But only those animals that actively engage in learning get to keep the new cells. In their mentally lazy companions new cells die after a couple of weeks.

Until relatively recently, scientists thought that no new neurons grew in the brains of adults and that every blow on the head or glass of wine after adolescence cut the number of brain cells. Over the past decade, though, neuroscientists have realised that young neurons do continue to appear in the brains of mature mammals—but what they might do is only now being pieced together. Many of these new brain cells are found in the hippocampus, a structure used to remember events, people and places. This suggested to Tracey Shors, of Rutgers University in New Jersey, that the cells might be involved in forming such memories.

To learn the fate of these new neurons, Dr Shors and her team used a chemical tag that attaches itself to cells that are dividing. On a given day, the researchers injected this chemical into the brains of rats. As a result, only the new brain cells that were born that day were labelled and thus the team could follow a cohort of new neurons over time.

The rats were treated in three different ways. Some of them were killed one week after the chemical tag had been injected and their brains were examined. About 5,000 labelled cells were found in each hippocampus. Members of a second group were placed in a dull, unstimulating environment for a further week. When the brains of these rats were examined, the labelled cells had all died.

Dr Shors and her colleagues trained members of further groups to learn something new in their final week. The researchers played a sound and then, after a set period of time that varied between each group, blew a puff of air into the rats' eyes, making them blink. After several repetitions, the animals learned to blink after hearing the noise in anticipation of the puff of air, and they timed their blinks to avoid it.

Looking at the brains of these animals, the researchers found that the labelled neurons had not only persisted but also appeared to mature into functionally wired neurons. Moreover, the rats that successfully completed the more difficult task, which involved a longer gap in time between the sound and the puff of air, had retained more new neurons than those assigned easier tasks, with shorter gaps.

It is not yet clear how learning triggers the retention of the new brain cells and the laying down of memories. Regardless of the details, though, this would appear to be a clear case of “use it or lose it”. So keep reading. It may be good for your brain.

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The Republicans

Uncertain which way to move

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The Republican Party, weighing up the prospects for next month's mid-term elections, is sick and confused, three new books argue

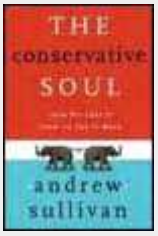
JUST about everything that could have gone wrong for the Republican Party has done—and then some. The ever-worsening news from Iraq is bad enough. Then, there is a far-reaching bribery scandal and, most recently, that trove of obscene e-mails from a Republican congressman to teenage boys working as pages on Capitol Hill. Except for the fact that both parties have conspired for years to rig the voting system in favour of incumbents, the Republicans hope that in next month's mid-term elections they will get away with merely losing control of the House of Representatives.

The strange thing is that many American conservatives actually want them to lose the House—and even to see the Senate go the same way. The authors reviewed here are among them. Their books try to explain this puzzling state of affairs and to fathom what has gone wrong with one of the most potent political movements America has ever seen.

Much the strangest, often the most perplexing, and always the most intriguing of the three is “The Conservative Soul”, by Andrew Sullivan, a leading political commentator and pre-eminent blogger. This avowedly personal essay is at least as much about Mr Sullivan as it is about American conservatism, but that is not a huge flaw because Mr Sullivan is an interesting man: a committed Catholic (he says), conservative (he insists), well-read in political philosophy and eager to show it, blessed with an insatiable appetite for ideas and argument, and gay. If the Republican Party is unsure what to make of Mr Sullivan, it can hardly be alone.

“The Conservative Soul” is a complicated book. Hidden inside it is a simpler one, and it is best to start there. This easier book argues that there are two kinds of conservatism: the divinely inspired fundamentalist kind—“theo-conservatism”—towards which the Republican Party has lately moved; and the more temperate

The Conservative Soul: How We Lost It, How to Get It Back
By Andrew Sullivan



HarperCollins; 294 pages; $25.95

Buy it at
Amazon.com
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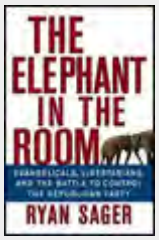
The Elephant in the Room: Evangelicals, Libertarians, and the Battle to Control the Republican Party
By Ryan Sager

kind of which Mr Sullivan approves—"conservatism as I would describe and explain it"—which is tolerant, intelligent, sceptical and open-minded. Many of the Bush administration's mistakes, this simpler book argues, flow from its fundamentalist tendencies—from its Manichean mindset, its obsession with the struggle between good and evil, and its consequent inattention to detail and results.

This reviewer is easily persuaded that theo-conservatism is bad. One does doubt, however, that Mr Sullivan is going to win over many theo-conservatives. And this simpler book, in any case, is occluded by a larger and far more complex enterprise, a work that is as much intellectual memoir as political essay.

Mr Sullivan's religious conviction is the problem. His preferred kind of conservatism, the non-evangelical open-minded sort, embodies principles that appeal to members of other faiths, or no faith. This kind of conservatism regards religious belief as an essentially private matter, separate from politics and protected from it. Yet Mr Sullivan also strives to ground conservatism-as-he-describes-it in his own Christianity, a faith as different from orthodox Catholicism as his political views are from the conservatism of most conservatives. Mr Sullivan's open-minded Catholicism is tolerant of abortion, for instance, and warmly supportive (in his view, for good, conservative, tradition-affirming reasons) of gay marriage.

Now and then, Mr Sullivan even seems to be searching for the one true Christian conservatism, an oddly fundamentalist quest for an avowed anti-fundamentalist. Whether this new conservatism, once fully formed to his liking, would be popular enough to sustain a political party seems doubtful. Mostly, though, this book is not a worked-out political programme but an unfinished account of Mr Sullivan's own struggle to integrate and make sense of his faith and his politics. What Mr Sullivan has to say about those subjects; indeed, what he has to say about most things is interesting, elegantly expressed and deeply thought through. "The Conservative Soul" is peculiar and inconclusive, but it is also intellectually challenging and thoroughly captivating.



Wiley; 248 pages; $25.95 and £17.99

Buy it at
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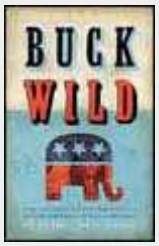
Buck Wild: How Republicans Broke the Bank and Became the Party of Big Government
By Stephen Slivinski



Nelson Current; 260 pages; $25.99

Buy it at
Amazon.com
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"The Elephant in the Room" is Ryan Sager's impressive run at the simpler book Mr Sullivan might have confined himself to. Mr Sager, a writer and blogger for the *New York Post*, also starts by dividing American conservatives into two groups, but in a more straightforward and familiar way. The southern branch is evangelical and socially conservative. The western branch has instincts that in many, though not all, places would be called liberal: it favours limited government, fiscal restraint and personal liberty. The Republicans based their success on an alliance of those two quite dissimilar constituencies. It was an unstable marriage, not to be taken for granted; that was the party's mistake.

Hungry for more

The Republicans' conquest of the South, wresting southern social conservatives from the Democratic Party, was the great political breakthrough—and consolidating that support has lately been the party's principal aim. The southern branch was given what it wanted, which sharpened its appetite for more, and the party kept on giving. The frugal westerners were neglected and marginalised. The result was big-government conservatism—and a failing marriage. Whether the alliance can still be saved is unclear. Mr Sager is hopeful and has some suggestions. The story of the impending break-up is excellent material, and the author tells it well.

"Buck Wild" is narrower still, even more straightforward in approach—and in its way every bit as valuable. Stephen Slivinski, a scholar at the Cato Institute, examines the development of big-government conservatism programme by programme. He explodes the claim that the Bush administration's vast increase in public spending can be attributed to the new demands of national security and the war in Iraq, costly though these are. In recent years, the administration has chosen to spend profligately even in areas where it was under no compulsion to do so. Public expenditures have risen faster in America than at any time since Lyndon Johnson. For chapter and verse on the administration's betrayal of fiscal conservatism, look no further.

Soon the party will find out whether it matters that these authors—intelligent conservatives, natural

Republican supporters—are in one way or another rooting for the other side. A drubbing is richly deserved, to be sure. For the sake of the ideas that Republicans used to champion, and for the sake of the party itself, a drubbing might indeed be the best thing.

The Conservative Soul: How We Lost It, How to Get It Back.
By Andrew Sullivan.
HarperCollins; 294 pages; $25.95

The Elephant in the Room: Evangelicals, Libertarians, and the Battle to Control the Republican Party.
By Ryan Sager.
Wiley; 248 pages; $25.95 and £17.99

Buck Wild: How Republicans Broke the Bank and Became the Party of Big Government.
By Stephen Slivinski.
Nelson Current; 260 pages; $25.99

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About sponsorship

Hungary, October 1956

Half a century of remembering

Oct 19th 2006 | BUDAPEST
From The Economist print edition

The Hungarian uprising has inspired a new generation of books

ANYONE puzzled by the recent violence in Budapest, the worst since the failed revolution of 1956, should look at the plaque concealed behind a curtain in a building on Republic Square. Once the headquarters of the Communist Party, it now houses the communists' successors, the ruling socialists, who are led by the youthful multi-millionaire and prime minister Ferenc Gyurcsany. The plaque commemorates victims of 1956: not those killed fighting Soviet tanks or hanged after the revolution was crushed. Rather, it venerates the communist functionaries who were beaten, lynched and set on fire when the rebels captured the building.

Looking at the powerful photographs in Erich Lessing's book, it seems as if what happened in Budapest was less an uprising against the Soviets than a civil war. His pictures show the corpses laid out in a row, covered with pictures of Hungary's hated dictator, Matyas Rakosi. Mr Lessing's work also illustrates how surreal urban warfare can be. During the worst of the fighting everyday life continued: housewives shopping for food delicately stepped around dead Soviet troops, passers-by stopped to watch an insurgent reload his rifle.

If Mr Lessing shows what the uprising looked like, Viktor Sebestyen, Charles Gati and Michael Korda seek to explain its causes and its course. All have excellent credentials: Mr Sebestyen is a British journalist of Hungarian origin; Mr Gati, also a native Hungarian, witnessed the revolution at first hand before fleeing west. Mr Korda, nephew of the more famous Alexander, a film-maker, drove to Budapest from Oxford University, bringing a car-load of medicines. His lively eyewitness account recalls the chaos and excitement of revolutionary Budapest.

Mr Sebestyen's book should become the standard work on the uprising. His early chapters set the scene and he is especially strong on the terror of the early 1950s, the Rakosi era that helped trigger the events. Politics in Stalinist Hungary operated a revolving door: officials were beaten near to death one day, returned to power another, dragged back to the prison cell the next. Mr Sebestyen uses multiple points of view to bring added perspectives from both Moscow and Washington, DC. Deft portraits of major characters—the tragic Imre Nagy, the duplicitous Janos Kadar and Yuri Andropov, the chilling Soviet ambassador to Budapest—bring the human drama alive and make for a gripping read.

“Failed Illusions” sheds new light on American policy, especially the controversial role of Radio Free Europe as it encouraged the rebels. Published by Stanford University Press as part of the Cold War International History Project, the book draws heavily on newly declassified archives in Budapest, Moscow and America, and extensive interviews by the author.

Mr Gati is strong on Nagy, the leader of the doomed revolution. The nationalist right in Hungary has sought to appropriate Nagy as an anti-communist figurehead. But as both Mr Sebestyen and Mr Gati show, Nagy was as much a communist as he was a Hungarian patriot. Nagy's dithering in the early days of the fighting, his continuing loyalty to the Soviet Union, his inability to break out

Revolution in Hungary: The 1956 Budapest Uprising
By Erich Lessing

Thames & Hudson; 252 pages; $50 and £35

Buy it at
Amazon.com
Amazon.co.uk

Twelve Days: The Story of the 1956 Hungarian Revolution
By Viktor Sebestyen

Pantheon; 368 pages; $26. Weidenfeld & Nicolson; £20

Buy it at
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Failed Illusions: Moscow, Washington, Budapest, and the 1956 Hungarian Revolt
By Charles Gati

of the Marxist mindset and move decisively helped seal the fate of the revolution. Yet perhaps that is not so surprising: Mr Gati tells in detail how, in Moscow during the 1930s, Nagy became an NKVD informant known as Agent Volodya. Mr Gati's excellent footnotes, several quite personal and poignant, give added depth to the story.

In the end, Nagy acquitted himself, at least in history's eyes, at his show trial before his execution in 1958. He neither submitted nor confessed and his courage made clear the dark farce of communist justice. The man who decided Nagy would die was Janos Kadar, his former comrade and Hungary's leader from 1956 until 1988. Roger Gough's admirable life of Kadar, aptly entitled “A Good Comrade”, untangles many of the contradictions around his life.

Mr Gough skilfully traces Kadar's development from illegitimate child of a poor countrywoman to idealistic young worker to cynical apparatchik. Yet Kadar invented “goulash communism”, turning Leninist logic on its head by proclaiming “All those who are not against us are with us.” It worked, after a fashion, and Hungary was the most peaceful, prosperous nation in the Communist bloc. As for the old party headquarters on Republic Square, Socialist officials whisper that they plan to demolish it soon, sensitive plaque and all. Even that may not be enough to banish the ghosts of Janos Kadar and his old comrade Imre Nagy.

Revolution in Hungary: The 1956 Budapest Uprising.
By Erich Lessing.
Thames & Hudson; 252 pages; $50 and £35

Twelve Days: The Story of the 1956 Hungarian Revolution.
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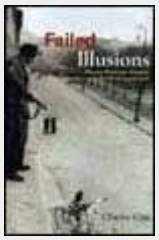
Failed Illusions: Moscow, Washington, Budapest, and the 1956 Hungarian Revolt.
By Charles Gati.
Stanford University Press; 280 pages; $24.95

Journey to a Revolution: A Personal Memoir and History of the Hungarian Revolution of 1956.
By Michael Korda.
HarperCollins; 221 pages; $24.95



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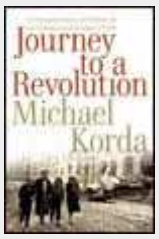

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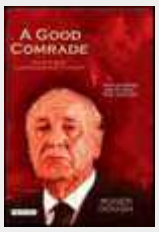

I.B. Tauris; 320 pages; $45 and £24.50

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About sponsorship

Armenians in Turkey

Where the past is another country

Oct 19th 2006
From The Economist print edition

WHAT has to happen before a nation can look honestly at the darkest chapters in its own past? Moments of truth can occur when a country is defeated, occupied and helpless, like Germany and Japan in 1945. At the other extreme, such moments are also possible when a nation feels so secure that it can discuss past misdeeds without fearing for its future existence: think of the British, French and Belgian historians now uncovering murky chapters of the colonial era. And there is a third answer: after a big revolution (like the Bolshevik one), the new rulers are often keen to show up the moral turpitude of their predecessors.

None of these conditions has ever prevailed in modern Turkey, although things came close after 1918; and that is why the fate of hundreds of thousands of Ottoman Armenians who died horribly in 1915 is still a bitterly disputed question, for diplomats and judges as well as scholars.

What is contested is whether, in addition to the overt orders given to deport the Armenians—on grounds that they were a fifth column for the tsarist enemy—secret orders were also given by the Committee of Union and Progress (CUP), the shadowy clique which wielded effective authority over the Ottoman empire, to make sure that very few Armenians survived the experience.

A Shameful Act: The Armenian Genocide and the Question of Turkish Responsibility
By Taner Akçam

Metropolitan Books; 448 pages; $30

Buy it at
Amazon.com
Amazon.co.uk

This timely and well-researched work by Taner Akçam, a Turkish-born scholar who now lives in America (and would risk prosecution if he tried to go home) highlights at least two things. First, how many foreign observers of the deportations, including Germans and Austrians who were allied to the Turks, did conclude that the intention was to kill, not just deport. And secondly, the book helps to explain why the conditions in which these events might be freely discussed in Turkey have never quite fallen into place.

The Ottoman empire did, of course, accept defeat by the Entente, and in the months that followed, Britain had much sway over the Ottoman institutions. From March 1920, Britain and its allies formally occupied Istanbul. But the occupation, at a time of British-backed Greek expansion in Anatolia, backfired: the real moral authority of the war victors over Turkey ebbed rapidly, as did the Turks' readiness to receive moral lessons from their foes. So too did Turkish willingness to accept that crimes had been committed against, as well as by, the eastern Christians.

Things might have been different. During the first world war, all decisions on the conduct of the war (and the treatment of the Armenians) were taken by the committee. When the war ended, its leaders fled, fearing prosecution for their atrocities against the Armenians. At that time, the Ottoman government was desperate to distance itself from the CUP's actions, and agreed readily to a series of trials in which the fate of the Armenians was considered; some grisly evidence came to light. But the mood of self-reproach was short-lived.

Mustafa Kemal (later Ataturk), the brilliant general who smashed the Greeks in 1922 and created modern Turkey, might in theory have renounced all the deeds of the Ottoman era—given that the republic he proclaimed was supposed to mark a rupture with the past. But as Mr Akçam shows, Ataturk's movement was too close to the committee for a clean break to occur. That laid the ground for today's odd situation—a modern republic that passionately defends, on pain of prosecution, the imperial regime which the republic's founders overthrew.

A Shameful Act: The Armenian Genocide and the Question of Turkish Responsibility.
By Taner Akçam.

Metropolitan Books; 448 pages; $30

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About sponsorship

Understanding poetry

Look deep into my eyes

Oct 19th 2006
From The Economist print edition

AP

The End of the Poem: Oxford Lectures
By Paul Muldoon

Farrar, Straus and Giroux; 403 pages; $30.
Faber and Faber; £25

Buy it at
Amazon.com
Amazon.co.uk

THIS book gathers together the 15 lectures delivered by Paul Muldoon, a Princeton-based Irish poet, when he was professor of poetry at Oxford University between 1999 and 2004. Mr Muldoon has some distinguished predecessors in the Oxford professorship: Matthew Arnold, Robert Graves, W.H. Auden and Seamus Heaney. Arnold, in particular, wrote with a ponderous gravity—the burdens of high office clearly weighed heavily upon his shoulders.

Mr Muldoon is very different. Disarmingly jaunty, as a lecturer he is much given to self-deflation, teasing and word-play. For all that, he is also committed to the serious business of the close reading and the explication of particular poems, word by word, line by line.

His chosen poems, by W.B. Yeats, Elizabeth Bishop, Marianne Moore and others, are printed in full at the beginning of each chapter. They are often long, difficult to take apart, and just as difficult to re-assemble. Muldoon entertains almost as much as he enlightens, an unusual and refreshing approach. He dives into the etymology of words, and then relates these discoveries to far-flung biographical and historical fact. At times, his insights can be acute, at others far-fetched and almost outrageously fanciful. What is more, he is often so closely engaged in peering into the darkest and smallest recesses in pursuit of oddities, that much of the poem remains in total obscurity, so that at its worst his method reads like a parody of textual criticism.

A major thrust of Mr Muldoon's argument is that a poem is not a self-sufficient construct made of words which can stand alone without any knowledge of the biography of its author. Biographical information can be enormously informative, he says, enlightening the reader as to the poet's real preoccupations. But this can be problematic.

Mr Muldoon writes at some length, for example, about the hostility between Ted Hughes and Marianne Moore. He teases out subtle linkages between the two of them, tiny “crypto-currents”, as he calls them, which demonstrate the extent to which the writers were preoccupied by each other, even without being fully aware of it themselves. Mr Muldoon speculates that the title of one of Hughes's early books, “Moortown”, together with some of its subject matter, amount to evidence of the fact that the idea of Marianne Moore was gnawing away at him because the name Moore is “present” in Moortown. As he puts it, this “fact” is “as clear an indicator as one might find of Hughes's desire simultaneously to include and occlude her influence.” Is this ridiculous? Or is it a brilliant *aperçu*?

Poems are often difficult to understand, but Mr Muldoon's literary method, for all his delightfully readable questings, seems to add hurdles rather than eliminate them. To try to argue that the real meaning of a poem can be discovered only if the reader brings to bear upon it abstruse, quasi-biographical “evidence”, and tiny, washed-up bits of etymological detritus, makes the reading and understanding of poetry into an elitist sport-cum-parlour game, undermining the notion that poetry has a universal appeal. Still, not many books of literary criticism make you laugh.

The End of the Poem: Oxford Lectures.

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About sponsorship

“King Lear” à la Russe

Cut and paste

Oct 19th 2006
From The Economist print edition

Lev Dodin has reworked Shakespeare's “King Lear”—with surprising results

Who is that can tell me who I am?

LEV DODIN, the 62-year-old artistic director of the Maly Drama Theatre of St Petersburg, is personable and unassuming. In conversation—he speaks only Russian—he is also light-hearted, in contrast with his work, which is stark, unsentimental and serious.

The first production he staged after he took over the theatre in 1983 was “Brothers and Sisters”, a play based on a novel by Fyodor Abramov which depicts in rich detail and with unabashed exuberance a community trying to rebuild itself under Stalinism. Mr Dodin feels Russians have become more fragile since the fall of communism—and more irrational. Over the past 23 years, it is the monster in everyone which has inspired his most vivid drama.

So it comes as no surprise that although he has never directed any Shakespeare plays, Mr Dodin has now turned to “King Lear”, the Bard's most ferocious tragedy. He admits that in doing “King Lear” you must “take the bull by the horns and no horns come bigger than this”. What he relishes, in particular, is the challenge of putting on a play that “poses questions that we all sooner or later have to face”. Not only is he staging the play, but he has also cut and reshaped it.

Thus, instead of always knowing who was right and who was wrong before the production even started, Mr Dodin sees his “King Lear” as offering a dialectic, between blamed and blamer, between one generation and the next, about who passes on what to whom. “What concerns me”, he says, “is how to portray that rather than slavishly follow a plot about good and evil.”

The result is a “King Lear” shorn of its pomp, with few of those great moments that English-speaking audiences have come to expect. The Fool, whose riddles can become wearing, has had many lines cut and instead, stage left, tinkles out tunes as a kind of facetious commentary on a bare-fronted piano, which eerily continues to play on its own once the Fool has vanished from the play. There are no storm effects when Lear loses his mind on the heath. Voices are rarely raised. At the back of the stage, a wall is lined with X-shaped wooden planks. On each side are panel-doors, contraptions which can be moved around on wheels to represent, for example, Poor Tom's hovel. There are no weapons and no soldiers.

What the audience sees instead is domestic anarchy: a fraught Lear (Petr Semak, pictured) messing up his old age by banishing Cordelia and insulting his two other daughters Goneril and Regan; a wimpish Gloucester (Sergey Kuryshev) being gulled by his dashing bastard son Edmund (Vladimir Seleznev). This “King Lear” is redolent of the claustrophobia and familial paralysis of Chekhov.

The three sisters—when they gather, in a hug, after Lear's first rant at Cordelia's inability to quantify her love for him, surely a nod at the parallel three sisters in Chekhov's great play—are brilliantly played by students: Elizaveta Boyarskaya (Goneril), Elena Solomonova (Regan) and Daria Rumyantseva (Cordelia). Costumed first in tight white dresses, then in billowing white skirts and ruffs, the girls are poised and seem genuinely abused rather than lachrymose, as Cordelia usually is, or serpentine, as Goneril and Regan are so often portrayed.

For Mr Dodin, the basic conflict is contained in the battle between the old and the young. “You cannot accuse your child of something and not accuse yourself at the same time. Similarly, you cannot, as a child, accuse your father of something without realising how deep your own shortcomings are. That is Lear's message.”

Traditionally minded audiences may not immediately be touched by this approach: with no full-blooded soliloquy from Edmund near the start, no duel between Edmund and Edgar at the end, no sense that King Lear himself, however unhinged, has regal status, this Maly version might seem perverse, or just unmoving.

But it is also bold, and it challenges audiences to think anew about a play that has become all too encrusted with theatrical clichés. Mr Dodin's “King Lear” played at London's Barbican theatre for five days earlier this month. Directors of the major festivals in Europe and America should think of giving this tough, Russian Shakespeare a wider viewing. It is as instructive as it is thoroughly contemporary.

“King Lear” is playing at the Maly Drama Theatre, St Petersburg, on November 1st and November 10th, and then at the MTUZ Theatre, Moscow, from November 22nd-24th. Tickets are available on +(7 812) 713 2028.

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Benito Martínez Abrogán

Oct 19th 2006
From The Economist print edition

EPA

Benito Martínez Abrogán, possibly the world's oldest man, died on October 11th, aged around 120

AMONG the attractions that led the conquistadors to hazard their lives on the Atlantic, alongside dreams of mountains of silver and men slicked head to foot in gold, lay the thought of a fountain of perpetual youth. Where this fountain was, no one could say exactly. They would know they had found it when, stumbling on some hidden valley, they would see centenarians tilling the fields and dancing with the energy of young men.

The New World was found; the fountain was not, though Ponce de León, sweating through Florida, surely had premonitions of geriatric aerobics to come. By the 20th century, the mythical source of youth had become politicised and had shifted continents. Stalin placed it in the Caucasus, in Georgia and Azerbaijan: for there men and women lived to extraordinary ages, preserved both by pure air and by communism.

The connection of long life with Marxist dialectic is not proven, but in Cuba it is assumed. There, at the International Conference on Satisfactory Longevity in May last year, Mercedes Matilde Nuñez, aged 102, sang a popular song; Juana Hernández Fernández, 103, and Professor Eduardo, 104, waltzed round the room to the tune “Almendra”; and Amada Hernández Fernández, 102, announced that she should really be in the kitchen, cooking up a storm of rice, chicken and vegetables with plenty of garlic and coriander.

The star of the show, however, was Benito Martínez Abrogán. He was not there in person, because he preferred to stay 240 miles east in Ciego de Ávila, breeding fighting cocks, growing bananas and tripping the light fantastic with any young nurse he could grab at the senior citizens' centre. He had turned up there on June 19th 2005 looking impressively dapper, in a woollen jacket and trilby hat and a freshly ironed shirt, to celebrate his 125th birthday.

His precise age was something of a mystery. According to his Cuban identity papers he had been in Cuba since 1925, but his age on arrival was uncertain. He had come from Haiti, and remembered just a little of it: a childhood spent near Cavaellon, a few words of Creole. The Cuban government sent officials to Haiti to check, but they turned up nothing. More officials talked to Mr Martínez's oldest neighbours; they attested that he had always been the most elderly person they knew. The man himself, beaming his huge toothless smile, declared that his year of birth was 1880. He could not tell the time, relying on the sun's angle and his own instincts to know when to eat or sleep. But that one date he knew. “I am”, he would say proudly, “the oldest person in the world.”

The regime of Fidel Castro concluded that Mr Martínez was perhaps 119; but that was good enough. Whether or not acknowledged by the “Guinness Book of Records”, it beat Elizabeth Bolden of Tennessee, a mere 116, and thus trumped the United States. In terms of longevity Cubans already matched Americans, living on average for 77 years. The country had so many centenarians, 2,721 out of 11.2m people, that Mr Castro's own doctor founded a club for them; and this in a country that spent only $251 per head a year on free lifelong health care, against $5,711 for patchy, elitist cover in the United States. Cuba contained, officials said, all the factors for a happy and lively old age: a good genetic mix, a diet without junk food, exercise, motivation and socialist solidarity.

Cassava and pork-fat

Mr Martínez, their poster-boy, certainly got exercise. He was a labourer all his life, cutting sugar cane (on Mr Castro's father's ranch, among others) and helping build the Central Highway. He worked so fast with the *guataca*, a small hoe, that his friends called him “El Avión”, the aeroplane. Like most Cubans, he had no car; he biked or walked barefoot, or waited for a fume-spilling bus with that patience and stoicism that calms down stress. Since food was rationed, he did not eat much except what he could grow.

Apart from all that, his life was not exemplary. He smoked until the age of 108 or so, cigarettes being handed out cheap among his rations. He never married, but chased many women. His “fresh” diet was mostly starchy cassava and sweet potatoes cooked in pork fat. Asked the secret of his youthfulness, he said he had never cheated a man or said bad things of other people. And he had a good socialist motivation to survive: he wished, someday, to shake Fidel Castro's hand.

Cuba's cradle-to-grave health care had in fact done little for him. He did not consult a doctor until he was around 115, and never went to hospital until the last few days of his life. Had he needed care earlier it would have been astonishingly good for a developing country, but standards are lower now than in the past. Money has been siphoned elsewhere, to “health tourism”; ordinary patients must bring their own lightbulbs and bedsheets. Cuba's best levels of health care, like its centenarians, are put on display mostly to show the world what it can do.

And what of that other elderly man, bearded and now frail, recovering slowly from “intestinal bleeding”, but still the longest-serving ruler in the world? Why, says his optimistic doctor, he may still survive to 125; for he is lucky enough to live in Cuba, the site of the Fountain of Youth.

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Overview

Oct 19th 2006
From The Economist print edition

Headline inflation eased in **America**, falling by 0.5% in September, thanks to a steep drop in energy prices. But consumer prices were still 2.1% higher than the year before, and core prices, excluding food and energy, rose by 0.2% last month and by 2.9% over the year, the quickest annual pace since 1996. The producer prices paid by companies fell by 1.3% in September. However, core producer prices increased by 0.6%.

America's dour **housing market** perked up a little. Housing starts jumped by 5.9% in September compared with a 6% drop in August, though they were still 17.9% below their rate a year earlier. Confidence among homebuilders rose after eight consecutive months of decline. The National Association of Home Builders/Wells Fargo Housing Market Index increased by one point in October after falling to a 15-year low the month before.

Industrial production in America declined by 0.6% in September.

Spirits sank in **Germany**. The ZEW economic-sentiment indicator, based on a survey of analysts and institutional investors, fell by 5.2 points in October to –27.4, far below its historical average of 34. The ninth monthly fall in a row was attributed to fear of an American slowdown, the threat of higher interest rates and the promise of heavier taxes.

Industrial production in the **euro area** increased by 1.8% in August compared with the previous month, thanks to strong activity in Portugal, Luxembourg and Belgium. Year-on-year growth in industrial output increased to 5.4% in August from 3% in July. Annual inflation in the euro area was revised downwards from 1.8% to 1.7% in September, compared with 2.3% in August.

Annual inflation in **Britain** declined to 2.4% in September, from 2.5% in the previous month, because of cheaper petrol prices. The unemployment rate increased to 5.5% in the three months to the end of August, up from 5.4% during the previous three months. Average pay, including bonuses, rose by 4.2% in the year to August.

The price index for corporate goods in **Japan**, which tracks producer prices, increased by 3.6% in September compared with the year before. It was the biggest annual increase since 1981.

The **Dow Jones Industrial Average** surpassed the 12,000 mark for the first time.

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Output, demand and jobs

Oct 19th 2006
From The Economist print edition

% change on year ago

	GDP latest	GDP qtr*	The Economist poll GDP forecasts 2006	The Economist poll GDP forecasts 2007	Industrial production latest	Retail sales (volume) latest	Unemployment % rate latest	Unemployment % rate year ago
Australia	+ 1.9 Q2	+ 1.3	+ 2.7	+ 3.2	– 1.0 Q1	+ 3.6 Q2	4.8 Sep	5.1
Austria	+ 3.0 Q2	+ 3.6	+ 2.6	+ 2.0	+ 7.9 Jul	+ 2.2 Jul	4.8 Sep	5.2
Belgium	+ 2.8 Q2	+ 3.1	+ 2.6	+ 2.0	+10.7 Aug	+ 1.6 Jul	13.0 Sep†	13.5
Britain	+ 2.6 Q2	+ 2.8	+ 2.6	+ 2.4	+ 0.7 Aug	+ 4.3 Aug	5.5 Aug‡	4.7
Canada	+ 2.9 Q2	+ 2.0	+ 2.9	+ 2.6	+ 0.7 Jul	+ 5.5 Jun	6.4 Sep	6.7
Denmark	+ 2.8 Q2	+ 6.5	+ 2.7	+ 2.1	+ 4.3 Aug	+ 3.8 Aug	4.4 Aug	5.7
France	+ 2.6 Q2	+ 4.9	+ 2.3	+ 2.0	+ 1.0 Aug	+ 3.6 Aug	9.0 Aug	9.9
Germany	+ 2.4 Q2	+ 3.6	+ 2.3	+ 1.3	+ 7.3 Aug	+ 1.0 Aug	10.6 Sep§	11.7
Italy	+ 1.5 Q2	+ 2.2	+ 1.6	+ 1.2	+ 3.5 Aug	– 0.7 Jul	7.0 Q2	7.8
Japan	+ 2.5 Q2	+ 1.0	+ 2.8	+ 2.1	+ 5.9 Aug	+ 0.3 Aug	4.1 Aug	4.3
Netherlands	+ 2.8 Q2	+ 4.8	+ 2.7	+ 2.2	+ 2.7 Jul	+ 4.6 Jun	5.6 Sep††	6.6
Spain	+ 3.7 Q2	+ 3.8	+ 3.5	+ 2.8	+ 5.0 Aug	+ 4.1 Aug	7.8 Aug	8.6
Sweden	+ 5.1 Q2	+ 5.4	+ 4.4	+ 3.0	+ 7.0 Aug	+ 8.0 Aug	4.9 Sep†	5.4
Switzerland	+ 3.2 Q2	+ 3.0	+ 3.0	+ 2.0	+ 4.3 Q2	+ 4.5 Aug	3.1 Sep†	3.6
United States	+ 3.5 Q2	+ 2.6	+ 3.4	+ 2.4	+ 5.6 Sep	+ 4.8 Aug	4.6 Sep	5.1
Euro area	+ 2.7 Q2	+ 3.8	+ 2.5	+ 1.8	+ 5.4 Aug	+ 2.4 Aug	7.9 Aug	8.5
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*							
Finland	+ 6.6 Q2	+ 7.6	na	na	+ 7.6 Aug	+ 5.5 Aug	7.8 Aug	8.2
Greece	+ 4.1 Q2	na	na	na	+ 2.3 Aug	+10.7 Jul	8.8 Q2	9.6
Iceland	+ 2.8 Q2	na	na	na	na	na	1.4 Jul†	2.0
Ireland	+ 5.0 Q2	+ 3.6	na	na	+ 5.5 Aug	+ 5.5 Aug	4.4 Sep	4.4
Luxembourg	+ 5.4 Q2	na	na	na	– 2.7 Jun	+ 2.3 Aug	4.1 Aug	4.1
New Zealand	+ 1.6 Q2	+ 1.7	na	na	+ 0.5 Q2	+ 0.9 Q2	3.6 Q2	3.7
Norway	– 0.5 Q2	+ 1.9	na	na	– 2.7 Aug	+ 5.0 Aug	3.0 Aug††	4.8
Portugal	+ 0.9 Q2	+ 3.8	na	na	+ 5.1 Aug	+ 2.5 Aug	7.3 Q2†	7.2

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ‡Jun-Aug; claimant count rate 3.0% in Aug. §EU harmonised rate 8.5% in Aug. ††Jul-Sep.

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Prices and wages

Oct 19th 2006
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2006	2007	latest		year ago	latest		year ago
Australia	+ 4.0	Q2	+ 2.5	+ 3.4	+ 2.8	+ 9.9	Q2	+ 6.9	+ 4.7	Q2	+ 5.8
Austria	+ 1.4	Sep	+ 2.4	+ 1.8	+ 1.7	+ 2.4	Sep	+ 1.5	+ 2.7	Sep	+ 2.3
Belgium	+ 1.2	Sep	+ 3.2	+ 2.0	+ 1.9	+ 5.9	Aug	+ 1.7	+ 2.1	Jul	+ 2.5
Britain	+ 2.4	Sep*	+ 2.5	+ 2.3	+ 2.2	+ 1.8	Sep	+ 3.3	+ 4.2	Aug†	+ 4.1
Canada	+ 2.1	Aug	+ 2.6	+ 2.4	+ 2.2	+ 3.6	Aug	– 0.3	+ 1.4	Jul	+ 0.4
Denmark	+ 1.5	Sep	+ 2.4	+ 2.0	+ 2.0	+ 4.3	Aug	+ 5.0	+ 3.2	Q2	+ 2.9
France	+ 1.2	Sep	+ 2.2	+ 2.0	+ 1.7	+ 3.9	Jul	+ 3.3	+ 3.1	Q2	+ 3.0
Germany	+ 1.0	Sep	+ 2.5	+ 1.8	+ 2.3	+ 3.0	Sep	+ 3.6	– 0.5	Jul	+ 1.3
Italy	+ 2.4	Sep	+ 2.0	+ 2.2	+ 2.0	+ 6.6	Aug	+ 3.7	+ 2.9	Aug	+ 2.9
Japan	+ 0.9	Aug	– 0.3	+ 0.3	+ 0.5	+ 3.6	Sep	+ 1.8	– 0.6	Aug	– 2.7
Netherlands	+ 1.1	Sep	+ 1.8	+ 1.6	+ 1.7	+ 4.9	Aug	+ 5.1	+ 2.0	Sep	+ 0.8
Spain	+ 2.9	Sep	+ 3.7	+ 3.8	+ 3.0	+ 5.7	Aug	+ 4.9	+ 3.1	Q2	+ 3.4
Sweden	+ 1.5	Sep	+ 0.6	+ 1.4	+ 1.9	+ 3.9	Aug	+ 4.2	+ 2.5	Jul	+ 2.9
Switzerland	+ 0.8	Sep	+ 1.4	+ 1.3	+ 1.3	+ 3.1	Aug	+ 1.0	+ 1.0	2005	+ 0.9
United States	+ 2.1	Sep	+ 4.7	+ 3.5	+ 2.4	+ 0.9	Sep	+ 6.9	+ 4.0	Sep	+ 2.7
Euro area	+ 1.7	Sep	+ 2.6	+ 2.2	+ 2.1	+ 5.7	Aug	+ 4.0	+ 2.4	Q2	+ 2.5
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 1.5	Sep	+ 1.2	na	na	+ 5.9	Sep	+ 3.8	+ 2.9	Q2	+ 3.7
Greece	+ 2.9	Sep	+ 3.9	na	na	+ 6.7	Aug	+ 5.5	na		na
Iceland	+ 7.2	Oct	+ 4.6	na	na	+11.4	Sep	+ 4.6	+10.6	Aug	+ 6.7
Ireland	+ 4.0	Sep	+ 3.0	na	na	+ 0.9	Aug	– 1.1	+ 2.2	Q1	+ 6.4
Luxembourg	+ 2.4	Sep	+ 2.9	na	na	+10.4	Jul	+ 5.5	+ 2.4	Jul	+ 0.9
New Zealand	+ 4.0	Q2	+ 2.8	na	na	+ 7.8	Q2	+ 4.7	+ 3.3	Q2	+ 2.6
Norway	+ 2.6	Sep	+ 2.0	na	na	+ 5.0	Sep	+17.9	+ 3.6	Q2	+ 3.8
Portugal	+ 3.0	Sep	+ 2.8	na	na	+ 4.9	Aug	+ 4.4	+ 1.1	Aug	+ 0.5

*RPI inflation rate 3.6% in Sep. †Jun-Aug.

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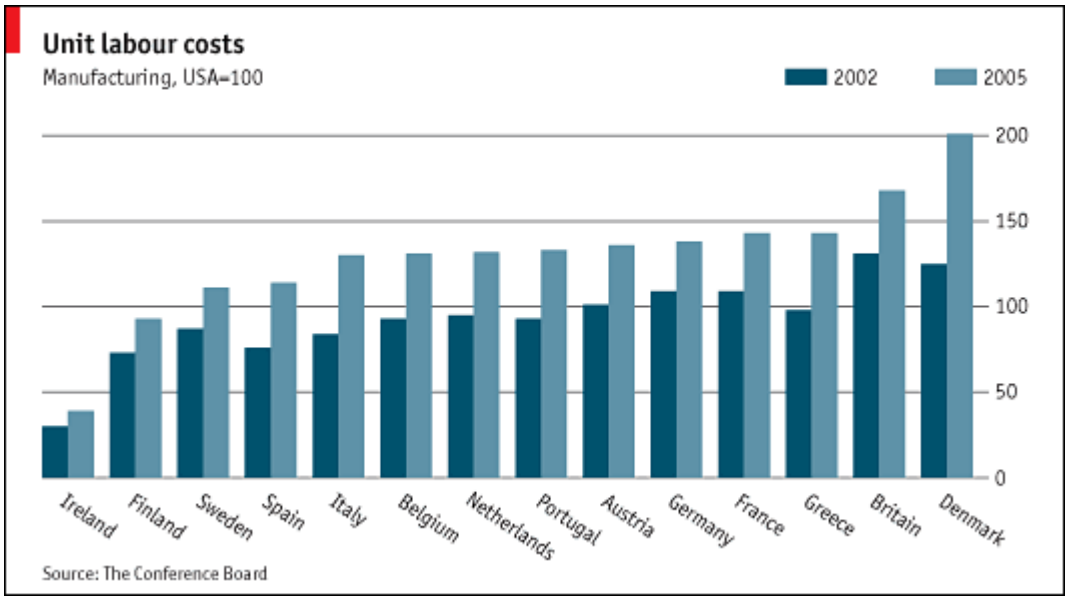
Unit labour costs

Oct 19th 2006
From The Economist print edition

Although America's manufacturing workers are better compensated than those in Europe, they are also more productive than most. As a result, the cost of labour per widget—or unit labour cost—is lower in America than in any European country except Finland and Ireland, according to the Conference Board and the Groningen Growth and Development Centre. The dollar's fall since 2002 has sharpened America's edge.



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Money and interest rates

Oct 19th 2006
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Oct 18th 2006) 3-mth money market		2-year gov't bonds	10-year gov't bonds		corporate bonds
	narrow	broad		latest	year ago		latest	year ago	
Australia	+10.2	+11.2	Aug	6.28	5.62	6.06	5.71	5.40	6.87
Britain	+ 5.0	+13.7	Aug	5.08	4.53	5.02	4.64	4.37	5.69
Canada	+13.6	+ 6.9	Aug	4.16	3.03	4.04	4.15	4.10	5.30
Denmark	+ 8.2	+ 7.4	Aug	3.62	2.20	3.73	3.78	3.18	5.14
Japan	+ 1.5	+ 0.6	Sep	0.34	0.02	0.77	1.79	1.50	1.99
Sweden	+ 0.1	+13.7	Aug	2.56	1.47	3.36	3.69	3.13	3.85
Switzerland	- 2.4	+ 1.6	Sep	1.85	0.80	2.00	2.48	1.96	2.59
United States	- 1.1	+ 4.4	Sep	5.24	3.95	4.85	4.76	4.46	5.75
Euro area†	+ 7.2	+ 8.2	Aug	3.51	2.19	3.66	3.77	3.23	4.41

*Narrow: M1 except Britain notes and coin and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 4.91%, Japan No. 282 1.80%. Central bank rates: US fed funds 5.25%, ECB refinancing 3.25%, BOJ overnight call 0.25%, BOE repo 4.75%. Sources: Bank of Canada, Commerzbank, Danske Bank, Global Insight, JPMorgan Chase, Lehman Brothers, Stockholmsbörsen, UBS, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Oct 19th 2006
From The Economist print edition

2000=100

	Oct 10th	Oct 17th*	% change on one month	% change on one year
Dollar index				
All items	177.2	184.6	+ 8.3	+ 35.4
Food	141.3	147.4	+ 8.6	+ 18.1
Industrials				
All	223.7	232.8	+ 8.0	+ 54.0
Nfa†	135.7	139.0	– 0.3	+ 2.2
Metals	271.7	284.0	+10.4	+ 78.1
Sterling index				
All items	144.8	149.8	+ 9.3	+ 26.6
Euro index				
All items	130.7	136.2	+ 9.7	+ 28.8
Yen index				
All items	196.7	203.4	+ 9.7	+ 38.8
Gold				
$ per oz	574.00	587.58	+ 1.5	+ 24.4
West Texas Intermediate				
$ per barrel	58.50	58.87	– 4.5	– 6.6

*Provisional. †Non-food agriculturals.

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Stockmarkets

Oct 19th 2006
From The Economist print edition

Market indices

	Oct 18th	2006 high	2006 low	% change on one week	% change on record high	% change on Dec 30th 2005 in local currency	% change on Dec 30th 2005 in $ terms
Australia (All Ordinaries)	5,282.1	5,318.2	4,708.8	+ 0.7	- 0.7	+12.2	+15.3
Austria (ATX)	4,044.9	4,344.4	3,324.1	+ 3.3	- 6.9	+10.3	+17.0
Belgium (Bel 20)	4,167.1	4,181.7	3,445.1	+ 0.9	- 0.4	+17.4	+24.6
Britain (FTSE 100)	6,150.4	6,172.4	5,506.8	+ 1.3	- 11.3	+ 9.5	+19.0
Canada (Toronto Composite)	11,966.0	12,487.3	10,904.3	+ 3.0	- 4.2	+ 6.2	+ 9.0
Denmark (OMXCB)	392.2	395.5	325.0	+ 1.1	- 0.8	+ 6.6	+13.2
France (SBF 250)	3,773.7	3,775.1	3,244.2	+ 0.9	- 14.1	+14.3	+21.3
France (CAC 40)	5,361.3	5,362.0	4,615.4	+ 0.9	- 22.6	+13.7	+20.6
Germany (DAX)*	6,182.8	6,186.5	5,292.1	+ 1.0	- 23.3	+14.3	+21.3
Italy (S&P/MIB)	39,479.0	39,650.0	34,850.0	nil	- 21.2	+10.6	+17.3
Japan (Nikkei 225)	16,653.0	17,563.4	14,218.6	+ 1.5	- 57.2	+ 3.4	+ 2.5
Japan (Topix)	1,638.7	1,783.7	1,458.3	+ 1.0	- 43.2	- 0.7	- 1.5
Netherlands (AEX)	490.1	493.4	412.9	nil	- 30.1	+12.2	+19.0
Spain (Madrid SE)	1,462.4	1,467.0	1,156.8	+ 1.3	- 0.3	+26.5	+34.2
Sweden (Affarsvarlden Gen)	340.7	341.8	275.2	+ 1.3	- 14.9	+16.1	+24.8
Switzerland (Swiss Market)	8,620.2	8,673.7	7,154.9	- 0.2	- 0.2	+13.7	+17.8
United States (DJIA)	11,992.7	11,992.7	10,667.4	+ 1.2	nil	+11.9	+11.9
United States (S&P 500)	1,366.0	1,369.1	1,223.7	+ 1.2	- 10.6	+ 9.4	+ 9.4
United States (NASDAQ Comp)	2,337.2	2,370.9	2,020.4	+ 1.3	- 53.7	+ 6.0	+ 6.0
Europe (FTSEurofirst 300)†	1,441.5	1,443.5	1,238.7	+ 1.1	- 15.5	+13.0	+19.9
Euro area (FTSE Euro 100)†	1,230.6	1,233.8	1,050.0	+ 0.7	- 20.6	+13.0	+19.9
World (MSCI)‡	1,401.9	1,406.3	1,243.9	+ 1.2	- 3.2	+11.5	+11.5
World bond market (Citigroup)††	638.5	653.7	612.1	nil	- 4.2	+ 2.9	+ 2.9

*Total return index. †In euro terms. ‡Morgan Stanley Capital International index includes individual markets listed above plus eight others, in $ terms. ††Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Oct 19th 2006
From The Economist print edition

	Trade balance*, $bn latest 12 months	Current-account balance $bn latest 12 mths	Current-account balance The Economist poll % of GDP, forecast 2006	Current-account balance The Economist poll % of GDP, forecast 2007	Exchange rate trade-weighted† 2000=100 Oct 18th	Exchange rate trade-weighted† 2000=100 year ago	Currency units per $ Oct 18th	Currency units per $ year ago	Currency units per £	Currency units per euro	Currency units per ¥100	Budget balance % of GDP 2006‡
Australia	− 10.6 Aug	− 41.0 Q2	− 5.6	− 5.3	118.3	117.9	1.33	1.33	2.48	1.66	1.11	+ 0.9
Austria	− 1.6 Jul	+ 6.4 Q1	+ 0.8	+ 0.8	105.8§	105.1	0.80	0.83	1.49	–	0.67	− 1.9
Belgium	+ 15.9 Aug	+ 6.5 Jun	+ 1.8	+ 2.0	107.6§	106.8	0.80	0.83	1.49	–	0.67	− 0.4
Britain	−142.0 Aug	− 64.4 Q2	− 2.7	− 3.0	102.2	99.0	0.54	0.57	–	0.67	0.45	− 3.4
Canada	+ 57.8 Aug	+ 28.6 Q2	+ 1.5	+ 1.0	127.2	123.4	1.14	1.18	2.12	1.42	0.95	+ 2.2
Denmark	+ 7.9 Aug	+ 7.0 Aug	+ 1.9	+ 1.8	106.6	105.8	5.96	6.23	11.1	7.46	5.00	+ 3.3
France	− 35.0 Aug	− 39.8 Aug	− 1.8	− 1.4	108.5§	107.5	0.80	0.83	1.49	–	0.67	− 2.9
Germany	+185.9 Aug	+105.5 Aug	+ 3.6	+ 3.6	110.2§	108.9	0.80	0.83	1.49	–	0.67	− 3.1
Italy	− 25.5 Aug	− 34.3 Jul	− 1.8	− 1.7	108.1§	107.1	0.80	0.83	1.49	–	0.67	− 4.2
Japan	+ 78.9 Aug	+166.9 Aug	+ 3.5	+ 3.5	79.3	83.2	119	116	222	149	–	− 5.2
Netherlands	+ 38.2 Aug	+ 46.2 Q2	+ 6.3	+ 6.0	108.5§	107.5	0.80	0.83	1.49	–	0.67	− 0.5
Spain	−104.9 Jul	− 97.1 Jul	− 8.4	− 8.0	105.9§	105.3	0.80	0.83	1.49	–	0.67	+ 1.1
Sweden	+ 19.7 Aug	+ 24.1 Q2	+ 6.5	+ 6.0	97.9	94.6	7.40	7.89	13.8	9.26	6.22	+ 1.7
Switzerland	+ 8.8 Sep	+ 55.3 Q2	+13.0	+12.5	104.5	106.3	1.27	1.30	2.38	1.59	1.07	− 0.2
United States	−850.9 Aug	−838.1 Q2	− 6.6	− 6.6	85.0	86.6	–	–	1.87	1.25	0.84	− 3.6
Euro area	− 24.6 Aug	− 52.3 Jul	− 0.4	− 0.2	118.1	115.6	0.80	0.83	1.49	–	0.67	− 2.3
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 11.1 Aug	+ 11.8 Aug	na	na	109.2§	108.3	0.80	0.83	1.49	–	0.67	+ 2.2
Greece	− 39.5 Jul	− 25.1 Jul	na	na	105.0§	104.3	0.80	0.83	1.49	–	0.67	− 3.0
Iceland	− 1.9 Aug	− 3.4 Q2	na	na	85.6**	100.9	68.2	60.7	127	85.3	57.3	+ 2.0
Ireland	+ 38.1 Jul	− 6.0 Q2	na	na	113.9§	112.4	0.80	0.83	1.49	–	0.67	− 0.3
Luxembourg	− 5.3 Jul	+ 4.2 Q2	na	na	107.6§	106.8	0.80	0.83	1.49	–	0.67	− 1.7
New Zealand	− 4.4 Aug	− 10.2 Q2	na	na	131.6	139.4	1.51	1.43	2.82	1.89	1.27	+ 4.6
Norway	+ 59.8 Sep	+ 56.5 Q2	na	na	103.3	112.1	6.78	6.51	12.7	8.48	5.69	+ 18.5
Portugal	− 22.5 Jul	− 16.7 Jul	na	na	105.9**	105.0	0.80	0.83	1.49	–	0.67	− 5.0

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, August average. ‡OECD forecast. **IMF, June average.

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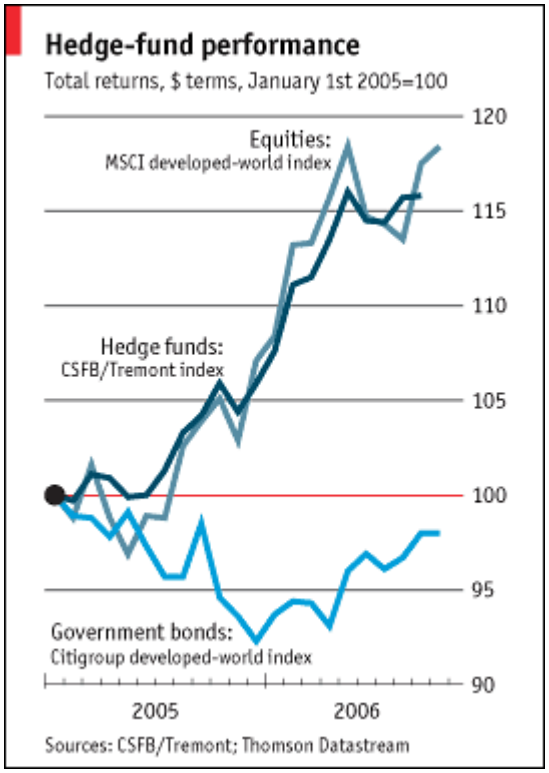
Hedge-fund performance

Oct 19th 2006
From The Economist print edition



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Overview

Oct 19th 2006
From The Economist print edition

Thanks to subdued inflation, **Brazil's** central bank felt free to cut its key lending rate by half a percentage point to 13.75%.

Industrial production in **Mexico** grew by 5.8% in the year to August. In **Poland** it expanded by 11.7%. Poland's current-account deficit widened to $6.6 billion in the year to August, compared with $4.9 billion in the year to July.

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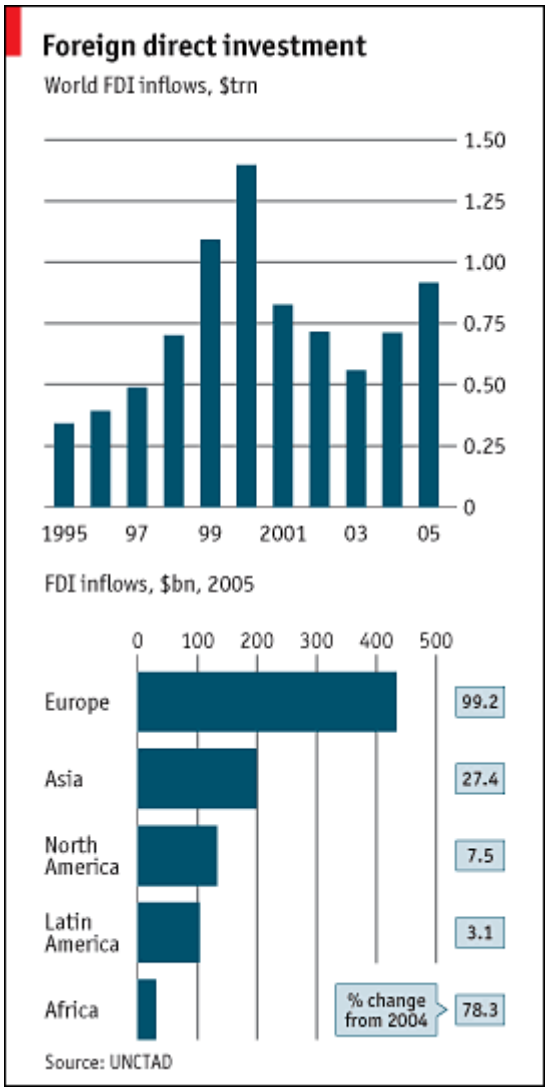
Foreign direct investment

Oct 19th 2006
From The Economist print edition

Direct investors, who exert influence over the enterprises they buy or build, ventured $916 billion across borders in 2005, according to the United Nations Conference on Trade and Development. This was 29% more than the year before, but still short of the $1.4 trillion invested in 2000. Developing countries, however, attracted a record amount of FDI, totalling $334 billion. Flows to the Middle East rose by 85%, to $34 billion, and investment in Africa grew by 78% to $31 billion, with large sums put into Egypt ($5.4 billion) and South Africa ($6.4 billion). Even the Congo attracted an estimated $1.3 billion of FDI in 2005, compared with just $15m the year before. China is not just a magnet for FDI, but also a rich source of it. Its flows of direct investment abroad grew from $1.8 billion in 2004 to $11.3 billion last year.



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Economy

Oct 19th 2006
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+10.4	Q3	+16.1	Sep	+ 1.5	Sep	+143.6	Sep	+160.8	2005	987.9	Sep
Hong Kong	+ 5.2	Q2	+ 5.3	Q2	+ 2.5	Aug	−14.9	Aug	+18.6	Q2	130.3	Sep
India	+ 8.9	Q2	+ 9.7	Aug	+ 6.3	Aug	−41.8	Aug	−13.2	Q2	158.3	Sep
Indonesia	+ 5.2	Q2	+12.2	Jul	+14.5	Sep	+36.4	Aug	+ 4.1	Q2	40.8	Sep
Malaysia	+ 5.9	Q2	+ 5.0	Aug	+ 3.3	Sep	+28.0	Aug	+20.0	Q2	79.0	Aug
Pakistan	+ 6.6	2006†	+13.0	Jul§	+ 8.7	Sep	−12.6	Aug	− 5.0	Q2	11.3	Aug
Philippines	+ 5.5	Q2	−10.4	Jul	+ 5.7	Sep	− 4.1	Jul	+ 4.3	Jun	18.8	Sep
Singapore	+ 7.1	Q3	+ 5.5	Aug	+ 0.7	Aug	+33.7	Sep	+38.3	Q2	129.4	Sep
South Korea	+ 5.3	Q2	+10.6	Aug	+ 2.4	Sep	+15.6	Sep	+ 5.8	Aug	228.2	Sep
Taiwan	+ 4.6	Q2	+ 4.8	Aug	− 1.2	Sep	+21.7	Sep	+20.6	Q2	261.6	Sep
Thailand	+ 4.9	Q2	+ 7.4	Aug	+ 2.7	Sep	− 1.9	Aug	+ 3.4	Aug	57.7	Aug
Argentina	+ 7.9	Q2	+ 7.6	Aug	+10.4	Sep	+11.3	Aug	+ 7.4	Q2	26.3	Aug
Brazil	+ 1.2	Q2	+ 3.2	Aug	+ 3.7	Sep	+46.3	Sep	+13.8	Aug	68.8	Aug
Chile	+ 4.5	Q2	+ 1.2	Aug	+ 2.8	Sep	+20.0	Sep	+ 2.2	Q2	17.6	Sep
Colombia	+ 6.0	Q2	+13.6	Jul	+ 4.6	Sep	+ 0.7	Jul	− 2.2	Q2	14.9	Sep
Mexico	+ 4.7	Q2	+ 5.8	Aug	+ 4.1	Sep	− 4.2	Aug	− 0.6	Q2	83.6	Aug
Peru	+ 9.2	Aug	+ 5.6	Jul	+ 2.0	Sep	+ 7.4	Aug	+ 1.3	Q2	14.3	Aug
Venezuela	+ 9.2	Q2	+ 7.8	Jul	+15.3	Sep	+37.2	Q2	+29.5	Q2	27.6	Aug
Egypt	+ 5.9	Q1	+ 4.0	2005†	+ 8.9	Aug	−11.2	Q1	+ 2.1	Q1	22.9	Sep
Israel	+ 6.2	Q2	+13.4	Jul	+ 1.3	Sep	− 7.9	Aug	+ 5.8	Q2	27.8	Sep
Saudi Arabia	+ 6.6	2005‡	na		+ 2.2	Jul	+126.5	2005	+90.7	2005	25.4	Aug
South Africa	+ 3.6	Q2	+ 4.2	Aug	+ 5.4	Aug	− 8.2	Aug	−13.3	Q2	22.3	Sep
Czech Republic	+ 6.2	Q2	+ 7.4	Aug	+ 2.7	Sep	+ 1.7	Aug	− 3.8	Q2	30.4	Sep
Hungary	+ 3.8	Q2	+ 9.0	Aug	+ 5.9	Sep	− 3.1	Aug	− 7.6	Q2	20.9	Sep
Poland	+ 5.5	Q2	+11.7	Sep	+ 1.6	Aug	− 3.6	Aug	− 6.6	Aug	46.7	Aug
Russia	+ 7.4	Q2	+ 5.6	Aug	+ 9.6	Sep	+142.3	Aug	+91.4	Q2	258.7	Sep
Turkey	+ 7.5	Q2	+ 4.8	Aug	+10.6	Sep	−50.6	Aug	−30.1	Aug	58.0	Aug
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+12.0	Q2	+10.6	Aug	+ 3.8	Sep	− 2.9	Jul	− 1.8	Jul	2.2	Jul
Latvia	+10.9	Q2	+ 7.6	Aug	+ 5.9	Sep	− 3.9	Jul	− 2.8	Jul	3.9	Aug
Lithuania	+ 7.7	Q2	na		+ 3.2	Sep	− 4.4	Aug	− 2.4	Jul	4.1	Aug
Slovakia	+ 6.2	Q2	+13.7	Aug	+ 4.6	Sep	− 3.0	Jul	− 4.4	Jun	12.5	Aug
Slovenia	+ 4.9	Q2	+10.9	Aug	+ 2.5	Sep	− 1.8	Aug	− 0.6	Jul	7.7	Jul

*Excluding gold, except Singapore and China; IMF definition. †Year ending June. ‡Economist Intelligence Unit estimate. §New series.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; Bank Leumi le-Israel; Standard Bank Group

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Financial markets

Oct 19th 2006
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Oct 18th		Dec 30th 2005	
	Oct 18th	year ago	Oct 18th	% a year		one week	in local currency	in $ terms
China	7.91	8.09	14.8	3.00	1,877.1	-0.2	+ 53.7	+ 56.9
Hong Kong	7.78	7.76	14.5	4.18	18,048.1	+1.0	+ 21.3	+ 20.8
India	45.4	45.1	84.7	6.59	12,858.5	+4.1	+ 36.8	+ 35.7
Indonesia	9,158	10,100	17,098	10.96	1,564.5	+0.7	+ 34.6	+ 44.6
Malaysia	3.67	3.77	6.86	3.80	975.9	+0.6	+ 8.5	+ 11.6
Pakistan	60.6	59.7	113	10.29	11,399.8	+4.7	+ 19.3	+ 17.7
Philippines	49.9	55.8	93.2	7.75	2,546.5	+0.8	+ 21.5	+ 29.0
Singapore	1.58	1.70	2.94	3.50	2,642.4	nil	+ 12.6	+ 18.7
South Korea	955	1,055	1,784	4.61	1,354.3	+2.2	- 1.8	+ 3.9
Taiwan	33.2	33.7	61.9	1.84	7,017.6	+0.2	+ 7.2	+ 6.1
Thailand	37.4	41.0	69.8	5.30	718.7	+3.0	+ 0.7	+ 10.4
Argentina	3.10	2.97	5.78	10.13	1,692.0	+3.8	+ 9.6	+ 7.2
Brazil	2.13	2.25	3.98	14.16	38,685.0	+0.9	+ 15.6	+ 26.7
Chile	527	538	984	5.16	10,971.1	+0.6	+ 19.2	+ 15.7
Colombia	2,349	2,284	4,386	6.23	9,743.3	+1.3	+ 2.4	- 0.3
Mexico	10.8	10.9	20.2	7.05	23,012.9	+2.8	+ 29.3	+ 26.9
Peru	3.24	3.39	6.06	4.47	10,806.2	+5.4	+125.0	+137.9
Venezuela	2,877§	2,871§	5,372	10.00	37,277.5	+1.2	+ 82.8	+ 64.3
Egypt	5.74	5.76	10.71	9.61	56,850.1	+3.1	+ 2.7	+ 2.7
Israel	4.27	4.64	7.98	5.40	888.8	+1.6	+ 7.4	+ 15.6
Saudi Arabia	3.75	3.75	7.00	5.22	10,545.4	-3.8	- 36.9	- 36.9
South Africa	7.58	6.59	14.2	8.60	23,209.3	+2.3	+ 28.3	+ 7.3
Czech Republic	22.6	24.8	42.3	2.69	1,514.6	+3.0	+ 2.8	+ 11.9
Hungary	213	211	397	8.25	22,527.6	+0.1	+ 8.4	+ 9.2
Poland	3.11	3.26	5.81	4.22	47,651.0	+2.8	+ 33.8	+ 40.1
Russia	27.0	28.6	50.3	11.50	1,626.4‡	+2.6	+ 35.6	+ 44.5
Turkey	1.47	1.37	2.74	20.26	39,743.8	+5.5	- 0.1	- 8.0
EM (MSCI)*	1.00	1.00	1.87	na	806.0	+2.6	+ 14.1	+ 14.1
EMBI+†	1.00	1.00	1.87	na	395.3	+0.6	+ 7.2	+ 7.2

*Emerging Mkts. †JPMorgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Trading market value.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; Bank Leumi le-Israel; Standard Bank Group

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